

Final Report: August 2018
Arkansas Tax Reform and Relief Legislative Task Force

I. Background.

Act 79 of the 2017 Regular Session, the Tax Reform and Relief Act of 2017, established the Arkansas Tax Reform and Relief Legislative Task Force (the “Task Force”), whose purpose under the Act is:

“to examine and identify areas of potential tax reform within the tax laws of the State of Arkansas and to recommend legislation to the General Assembly for consideration during the 2019 regular session in order to:

- (A) Modernize and simplify the Arkansas tax code;*
- (B) Make the Arkansas tax laws competitive with other states in order to attract businesses to the state;*
- (C) Create jobs for Arkansas; and*
- (D) Ensure fairness to all individuals and entities impacted by the tax laws of the State of Arkansas.”*

The Act further required the Task Force to submit a preliminary report of its findings to the Governor, the Speaker of the House of Representatives, and the President Pro Tempore of the Senate by December 1, 2017, and to file a final report with the same entities on or before September 1, 2018.

On December 22, 2017, the Task Force filed with the Governor, the Speaker, and the President Pro Tempore its preliminary report, as compiled by its consultant PFM Group Consulting, LLC. On January 8, 2018, the Task Force made the determination to terminate its contract with PFM. Since that date, the Task Force has utilized the services of the Bureau of Legislative Research (BLR), the Department of Finance and Administration (DFA), and economists from the Tax Foundation and the Institute on Taxation and Economic Policy (ITEP) to assist the members with data gathering and legal and fiscal analyses of the Arkansas tax code that the Task Force has examined as well as its proposed recommendations. The Task Force has also heard from multiple groups and individuals in the general public providing input on Task Force proposals for tax reform and relief, as it works towards its final proposal package.

The work of the Task Force will continue beyond submission of the September 1, 2018 report. The Task Force does not expire until December 31, 2018, and plans to use the months following this report to refine its tax reform and relief package for introduction during the 2019 legislative session. As you review this report, please keep in mind that it is not a static document, but one that is subject to revision or modification by the Task Force as it works to refine its final recommendations.

II. Work of the Task Force in 2018.

Beginning in March of 2018, the Task Force approached its workload by dividing the tax code into smaller categories on which it would receive information, make proposals to be further refined, and then vote on whether to include those proposals in the final report. The categories studied by the Task Force were: Sales and Use Tax (March 2018), Income Tax (April 2018), Property Tax (May 2018), and Excise and Miscellaneous Taxes (June 2018). The following reflects the proposals from each of those categories that have received approval of the Task Force for inclusion in this final report.

A. Sales and Use Tax.

The following recommendations have been adopted by the Task Force with regard to sales and use tax:

1. ***Regular Review of all Sales and Use Tax Exemptions.*** The Task Force recommends that a comprehensive review of all Arkansas sales and use tax exemptions be conducted at regular intervals in order to determine the feasibility of continuing each exemption based on a cost-benefit analysis of the impact on state revenues.
2. ***Designation of Revenue Generated.*** The Task Force recommends that use of any revenue resulting from a repeal of a sales tax exemption be designated towards offsetting income tax cuts included in its tax reform and relief package. The purpose of repealing exemptions is not to generate revenue for the state.
3. ***Local Sales Tax Caps.*** The Task Force recommends that a maximum rate be established for the total aggregate amount of sales and use tax that may be levied by a county or municipality, effective for tax years beginning January 1, 2019.

This recommendation would create the following maximum rates:

- The total aggregate amount of sales and use tax that may be levied by a county for general purposes, capital improvements, capital improvements of a community college, food and lodging (also known as the advertising and promotion tax), and economic development may not exceed a total aggregate rate of three percent (3%), effective for tax years beginning January 1, 2019. However, any county that has a total aggregate sales and use tax rate that exceeds three percent (3%) on January 1, 2019, may continue levying a total aggregate sales and use tax rate beyond the three percent (3%) maximum.
- The total aggregate amount of sales and use tax that may be levied by a municipality for general purposes, capital improvements, the temporary

acquisition, construction, or improvements of parks, food and lodging (also known as the advertising and promotion tax), and economic development may not exceed a total aggregate rate of four percent (4%), effective for tax years beginning January 1, 2019. However, any municipality that has a total aggregate sales and use tax rate that exceeds four percent (4%) on January 1, 2019, may be permitted to continue levying a total aggregate sales and use tax rate beyond the four percent (4%) maximum.

Fiscal Analysis: DFA expects there to be no fiscal impact at the State level when creating a maximum rate on municipal sales tax at four percent (4%) and a county sales tax at three percent (3%) because these are local revenues that are sent to the city and county. DFA's records also indicate that there is currently only one (1) county exceeding the proposed cap.

4. ***Repeal the Sales Tax Exemption for Coin-Operated Car Washes.*** The Task Force recommends the sales tax exemption for services provided by coin-operated car washes where the labor is performed solely by the customer or mechanical equipment be expanded to include services provided by all car washes under Arkansas Code § 26-52-301(3)(B)(ii), beginning July 1, 2019.

It is further recommended that a new fee be created that would be paid by all car wash operators in Arkansas based on the amount of water used by the car wash operator. Under this recommendation, a car wash operator would pay a monthly or annual fee that would be deposited as general revenues, beginning July 1, 2019, as follows:

- If the car wash operator uses water from a public water system, a monthly fee of one dollar (\$1.00) per one hundred (100) gallons of water used would be assessed on the car wash operator's monthly water bill; and
- If the car wash operator uses water from a private well or non-public water system, an annual fee of one hundred dollars (\$100) for each self-service bay and one thousand dollars (\$1000) for each car wash tunnel owned by the car wash operator would be assessed on the car wash operator.

Fiscal Analysis: According to DFA, exempting all car washes from the sales tax would result in an estimated loss of one million eight hundred one thousand dollars (\$1,801,000), of which one million two hundred forty-seven thousand dollars (\$1,247,000) would be general revenue. DFA is unable to determine the total of the monthly fee or annual fee proposed. This is due to the fact that DFA does not have information regarding the amount of water, source of water, or specifics regarding the operation of these businesses. However, the revenue from the monthly and annual fees would offset, at least in part, the revenue loss resulting from the extension of the sales tax exemption.

5. ***Repeal the Sales Tax Exemption on Sales of Four-Wheelers and All-Terrain Vehicles for Farm Use.*** The Task Force recommends that the sales tax exemption on all purchases of four-wheelers and ATVs used as farm equipment and machinery be repealed and replaced with a tax rebate, effective for tax years beginning January 1, 2019.

The purpose of this recommendation is to provide economic relief to farmers from Arkansas sales tax on purchases of farm equipment and machinery used exclusively and directly in farming while limiting the potential for abuse of the sales tax exemption provided for purchases of farm equipment and machinery used exclusively and directly for farming under Arkansas Code § 26-52-403.

The form and manner of the application for the sales tax rebate to be used by a farmer would be administered by DFA.

Fiscal Analysis: According to DFA, shifting from an exemption to a rebate for agriculturally qualified four-wheelers and ATVs would not have an immediate impact on the state tax revenue. DFA states that the administrative costs of additional filing requirements for farmers claiming a tax rebate would be offset by a reduction in the number of improperly claimed exemptions that are found through audit.

6. ***Repeal Sales Tax Exemptions for Named Entities.*** The Task Force recommends repealing all sales tax exemptions for named nonprofit entities and creating new, more generalized exemptions for these types of nonprofit entities, effective beginning July 1, 2019. The purposes of this recommendation are to eliminate any potential constitutional issues relating to special legislation for sales tax exemptions provided to specific nonprofit entities and to promote a more fair and equitable sales tax exemption for all nonprofit entities in Arkansas.

Under this proposal the sales tax exemptions for the following named nonprofit entities would be repealed and replaced with generalized sales tax exemptions:

- Arkansas Entertainers Hall of Fame Board under Arkansas Code § 13-9-104;
- Boys' and Girls' Clubs of America and any local councils under Arkansas Code § 26-52-401(8);
- Poets Roundtable of Arkansas under Arkansas Code § 26-52-401(9);
- 4-H Clubs and FFA Clubs located in Arkansas, the Arkansas 4-H Foundation, the Arkansas Future Farmers of America Foundation, and the Arkansas Future Farmers of America Association under Arkansas Code § 26-52-401(10);
- Arkansas Veterans' Home under Arkansas Code § 26-52-401(25);
- Habitat for Humanity under Arkansas Code § 26-52-401(31);
- The Salvation Army under Arkansas Code § 26-52-401(33);
- Heifer Project International, Inc. under Arkansas Code § 26-52-401(34);

- Arkansas Symphony Orchestra Society under Arkansas Code § 26-52-401(37);
- Arkansas Black Hall of Fame Foundation under Arkansas Code § 26-52-401(39);
- Fort Smith Clearinghouse under Arkansas Code § 26-52-424; and
- Arkansas Search Dog Association, Inc. under Arkansas Code § 26-52-443.

Fiscal Analysis: DFA is unable to provide a fiscal analysis for this recommendation. There are an unknown number of nonprofit and not-for-profit entities that may prove eligible for an exemption under the proposal that would create an unknown fiscal impact that DFA is unable to quantify. Any definitions that would apply to the listed entities would likely also apply to other entities not currently listed and therefore may create a fiscal impact for entities not currently able to purchase goods and services exempt from Arkansas sales and use tax.

7. ***Repeal the Sales Tax Exemption for Magazine/Publication Subscription Sales.*** The Task Force recommends that the sales tax exemption on the sale of any publication, other than newspapers, through regular subscription under Arkansas Code § 26-52-401(14) be repealed. This recommendation is contingent on the passage of a law in the State of Arkansas that requires the collection of sales tax by remote sellers (See Sales and Use Tax Recommendation 8, below).

Fiscal Analysis: According to DFA's "Sales and Use Tax Revenue Impact of Exemptions" presentation to the Task Force on March 19, 2018, repeal of the sales tax exemption for sales of any publication, other than newspapers, through regular subscription may result in a per year increase of approximately one million five hundred and fifty-six thousand dollars (\$1,556,000) in general revenues based on FY11.

8. ***Require Remote Sellers to Collect and Remit Arkansas Sales and Use Tax.*** The Task Force recommends requiring out-of-state sellers who do not have a physical presence in the state and who have more than one hundred thousand dollars (\$100,000) in sales or at least two hundred (200) separate sales transactions in Arkansas to collect and remit Arkansas sales and use taxes. This requirement would not be retroactive, and any revenues collected as a result of this proposal would be dedicated to reducing taxes. This recommendation would also repeal § 26-51-201(e), which provides for the reduction of the four and five-tenths percent (4.5%) income tax rate for middle-income earners to be reduced based on collections by out-of-state sellers who do not have a physical presence in the state.

Fiscal Analysis: Based on information DFA presented to the Task Force on July 27, 2018, the estimated impact of enacting the proposed requirement for certain out-of-state sellers to collect and remit Arkansas sales and use taxes would be thirty-five million three hundred seventy-four thousand dollars

(\$35,374,000), with twenty-four million four hundred ninety-one thousand dollars (\$24,491,000) representing the estimated increase in general revenue.

B. Income Tax.

The following recommendations have been adopted by the Task Force with regard to individual and corporate income tax:

1. ***Legislative Review of all Individual and Corporate Income Tax Deductions, Exclusions, and Credits.*** The Task Force recommends a regularly occurring legislative review process of all individual income tax and corporate income tax deductions, exclusions, and credits, in order to determine the feasibility of continuing each deduction, exclusion, or credit based on a cost-benefit analysis of the impact on state revenues.
2. ***Repeal the Throwback Rule.*** The Task Force recommends repealing the “throwback rule” for multistate business income under Arkansas Code § 26-51-716, effective for tax years beginning January 1, 2019.

The “throwback rule” is part of the calculation used by Arkansas concerning the apportionment of business income by multistate businesses for income tax purposes. Arkansas uses an apportionment formula consisting of property, payroll, and double sales factors to apportion income of a multistate business. Under Arkansas law, all sales must be reported somewhere, otherwise a taxpayer will have untaxed “nowhere” income. “Nowhere” sales are recaptured and placed in the Arkansas sales factor under Arkansas Code § 26-51-716, which is referred to as the “throwback rule.”

Fiscal Analysis: DFA estimates that repealing the “throwback rule” would have resulted in an estimated revenue reduction of twenty-four million five hundred thousand dollars (\$24,500,000) for fiscal year 2018, based on the fiscal impact statement prepared for HB1790 of 2017, which proposed to repeal the “throwback rule” under Arkansas Code § 26-51-716.

3. ***Single Sales Factor Apportionment.*** The Task Force recommends amending the apportionment formula for taxing multistate business income to use a single sales factor apportionment, effective for tax years beginning January 1, 2019.

Under Arkansas Code § 26-51-709, Arkansas apportions all business income owed to the state using a three-factor formula with a double-weighted sales factor. Arkansas calculates apportionment by adding a business’s property, payroll, and double the sales and dividing the sum by four (4). Under this proposal, multistate business income would be apportioned by dividing the taxable entity’s gross receipts from business conducted in Arkansas by the taxable entity’s gross receipts from its entire business nationwide.

Fiscal Analysis: According to DFA, amending the apportionment formula for taxing multistate business income to use a single sales factor would result in an estimated increase of eight million eight hundred thousand dollars (\$8,800,000) in general revenues based on fiscal year 2016.

4. ***Net Operating Losses.*** The Task Force recommendation is to incrementally increase the carry-forward period on net operating losses for all businesses to twenty (20) years. Currently, Arkansas tax law states that net operating losses may be carried forward for a maximum of five (5) years under Arkansas Code § 26-51-427, with the exception that the net operating loss carry-forward period for steel manufacturers under Arkansas Code § 15-4-2404 is a maximum of ten (10) years.

Under this recommendation, the net operating loss carry-forward period under Arkansas Code § 26-51-427 would be incrementally increased from five (5) years to twenty (20) years as follows:

- For the tax year beginning January 1, 2019, the net operating loss carry-forward period would be increased to eight (8) years;
- For the tax year beginning January 1, 2020, the net operating loss carry-forward period would be increased to eleven (11) years;
- For the tax year beginning January 1, 2021, the net operating loss carry-forward period would be increased to fourteen (14) years;
- For the tax year beginning January 1, 2022, the net operating loss carry-forward period would be increased to seventeen (17) years; and
- For tax years beginning on or after January 1, 2023, the net operating loss carry-forward period would be increased to twenty (20) years.

The net operating loss-carry forward period for steel manufacturers under Arkansas Code § 15-4-2404 would also be incrementally increased from ten (10) years to twenty (20) years as follows:

- For the tax year beginning January 1, 2020, the net operating loss carry-forward period would be increased to eleven (11) years;
- For the tax year beginning January 1, 2021, the net operating loss carry-forward period would be increased to fourteen (14) years;
- For the tax year beginning January 1, 2022, the net operating loss carry-forward period would be increased to seventeen (17) years; and
- For tax years beginning on or after January 1, 2023, the net operating loss carry-forward period would be increased to twenty (20) years.

Fiscal Analysis: DFA projects that increasing the net operating loss carry-forward period under this recommendation would result in a loss of approximately one hundred fifty-nine million four hundred eighty-four thousand dollars (\$159,484,000) in fiscal year 2044 and every year thereafter.

According to DFA the breakdown of revenue loss from corporate income tax and individual income tax when implementing the proposal, starting in tax year 2025 is as follows:

Tax Year	Fiscal Year	Carry Forward Year	Estimated Revenue Loss – Corporate Income Tax	Estimated Revenue Loss – Individual Income Tax	Total Estimated Revenue Loss
2025	2026	6	\$12,879,618	\$3,954,796	\$16,834,414
2026	2027	7	\$25,081,360	\$7,701,445	\$32,782,805
2027	2028	8	\$36,605,229	\$11,239,946	\$47,845,175
2028	2029	8	\$36,605,229	\$11,239,946	\$47,845,175
2029	2030	9	\$47,451,222	\$14,570,301	\$62,021,523
2030	2031	10	\$57,619,341	\$17,692,508	\$75,311,849
2031	2032	11	\$67,109,586	\$20,606,568	\$87,716,154
2032	2033	11	\$67,109,586	\$20,606,568	\$87,716,154
2033	2034	12	\$75,921,956	\$23,312,481	\$99,234,437
2034	2035	13	\$84,056,451	\$25,810,247	\$109,866,698
2035	2036	14	\$91,513,072	\$28,099,866	\$119,612,938
2036	2037	14	\$91,513,072	\$28,099,866	\$119,612,938
2037	2038	15	\$98,291,818	\$30,181,338	\$128,473,156
2038	2039	16	\$104,392,689	\$32,054,662	\$136,447,351
2039	2040	17	\$109,815,686	\$33,719,839	\$143,535,525
2040	2041	17	\$109,815,686	\$33,719,839	\$143,535,525
2041	2042	18	\$114,560,808	\$35,176,869	\$149,737,677
2042	2043	19	\$118,628,056	\$36,425,752	\$155,053,808
2043	2044	20	\$122,017,429	\$37,466,488	\$159,483,917

5. **Individual Income Tax Brackets.** The Task Force recommends amending and simplifying the Arkansas individual income tax rates and brackets under Arkansas Code § 26-51-201, effective for tax years beginning January 1, 2019. The Task Force considered three (3) possible options for reforming the individual income tax brackets, as follows:

a. **“Option A”**, which would reduce the number of individual income tax tables from three (3) to one (1) and reduce the top marginal rate for individuals from six and nine-tenths percent (6.9%) to six and five-tenths percent (6.5%). The individual income tax table under this recommendation would be as follows:

Individual Income Tax Bracket	Tax Rate
\$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+	6.5%

- b. **“Option B” combined with an Earned Income Tax Credit**, which would reduce the number of individual income tax tables from three (3) to one (1) and reduce the top marginal rate for individuals from six and nine-tenths percent (6.9%) to six and five-tenths percent (6.5%). The individual income tax table under Option B would be as follows:

Option B	
Individual Income Tax Bracket	Tax Rate
\$0-\$4,299	0.9%
\$4,300 - \$8,399	2.4%
\$8,400 - \$12,599	3.4%
\$12,600 - \$20,999	4.4%
\$21,000 - \$35,099	5.0%
\$35,100 - \$80,000	6.0%
\$80,000+	6.5%

The simplification of the individual income tax brackets and tables under this proposal would be combined with a refundable Earned Income Tax Credit (EITC) of ten percent (10%) of the federal EITC.

- c. **Reduction of the Top Individual Income Tax Rate**, which would reduce the top personal income tax rate from 6.9% to 6.0% but would not affect the rate in any of the other brackets.

At its meeting on August 7, 2018, the Task Force members were asked to rank the three (3) options regarding individual income tax rates, numbering them one through three, with one being their preferred option and three being their least favorite option. After the rankings were tallied, **Option A was determined to be the preference of the Task Force**, and is adopted as its recommendation herein.

Option A Fiscal Analysis: DFA estimates that the proposed recommendation for amending and simplifying the individual income tax brackets as described in Option A, above, will result in a revenue impact of \$276,437,336, as follows:

<u>Brackets</u>		<u># of Returns</u>	<u>Revenue</u>	<u>Revenue Impact</u>
\$0 to \$4,299	0.0%	139,298	\$24,086	-\$505,602
\$4,300 to \$8,399	2.0%	88,007	\$998,694	-\$973,825
\$8,400 to \$12,599	3.0%	97,904	\$3,899,035	-\$1,505,319
\$12,600 to \$20,999	3.4%	206,267	\$45,060,925	-\$12,695,334
\$21,000 to \$35,099	5.0%	249,458	\$185,030,490	-\$36,688,817
\$35,100 to \$80,000	6.0%	315,511	\$645,096,527	-\$67,061,340
\$80,000 and up	6.5%	<u>170,365</u>	<u>\$1,460,366,876</u>	<u>-\$157,007,099</u>
		1,266,810	\$2,340,476,633	-\$276,437,336

6. **Corporate Income Tax Brackets.** The Task Force recommends reducing the corporate income tax rates and creating a tax trigger for further reductions to the top marginal corporate income tax rate under Arkansas Code § 26-51-205, effective for tax years beginning January 1, 2019.

First, this recommendation would reduce the rate of corporate income tax on corporate income between twenty-five thousand one dollars (\$25,001) and one hundred thousand dollars (\$100,000), inclusive, from six percent (6%) to five and nine-tenths percent (5.9%), effective tax years beginning January 1, 2019.

Second, this recommendation would create a tax trigger for reducing the top marginal rate of corporate income tax on corporate income in excess of one hundred thousand dollars (\$100,000) to five and nine-tenths percent (5.9%), effective for tax years beginning January 1, 2019.

The structure of the tax trigger will be determined at a later date by the Task Force based on a comprehensive plan for providing tax reform and relief.

Fiscal Analysis: Based on the most recent corporate income tax returns, DFA estimates that the fiscal impact of this recommendation would be an initial loss of six million five hundred thousand dollars (\$6,500,000) and a total phased-in fiscal impact to be a loss of thirty-eight million seven hundred thousand dollars (\$38,700,000), if the top marginal rate for corporate income is reduced to five and nine-tenths percent (5.9%).

7. **Repeal the Capital Gains Tax Exemption.** The Task Force recommends repealing the capital gains tax exemption for capital gains over ten million dollars (\$10,000,000) under Arkansas Code § 26-51-815(b)(3), effective for tax years beginning January 1, 2019.

The revenue generated by the repeal of the capital gains tax exemption for capital gains over ten million dollars (\$10,000,000) would be utilized to reduce the top income tax rate on individual earners or to reduce the income tax rate for all individual earners.

Fiscal Analysis: According to DFA, the repeal of the capital gains tax exemption for capital gains over ten million dollars (\$10,000,000) under Arkansas Code § 26-51-815 may result in a general revenue increase of four million six hundred and fifty thousand dollars (\$4,650,000).

8. ***Repeal the Political Contribution Income Tax Credit.*** The Task Force recommends the repeal of the political contribution income tax credit, effective for tax years beginning January 1, 2019.

Fiscal Analysis: According to DFA, repeal of the political contributions income tax credit may result in an increase of seven hundred fifty-nine thousand dollars (\$759,000) per year in general revenue based on figures from fiscal year 2016.

9. ***Create a Pass-Through Entity Tax.*** The Task Force recommends creating an optional pass-through entity tax (PET) for Arkansas businesses that operate as pass-through entities in Arkansas. The purpose of this recommendation is to increase fundamental fairness between owners of C corporations and owners of pass-through entities as it relates to each owner's ability to fully deduct state and local taxes (SALT) from the owner's federal income tax liability.

The new federal tax law, the Tax Cuts and Jobs Act (TCJA), P.L. 115-97, limits the federal SALT deduction for individual filers to ten thousand dollars (\$10,000). However, under the TCJA, a C corporation may take an unlimited SALT deduction. This means that owners of C corporations are able to reduce their federal income tax liability to a greater extent than owners of pass-through entities, as it relates to the SALT deduction.

Under current law, a pass-through entity reports Arkansas income attributable to the owners of the pass-through entity directly to the Department of Finance and Administration (DFA), and the owners of the pass-through entity are required to pay income tax to DFA. However, C corporations pay Arkansas income tax directly to DFA. This recommendation would allow a pass-through entity to elect to pay Arkansas income tax directly to DFA in the same manner as a C corporation, which would allow a pass-through entity to take a SALT deduction under federal law in the same manner as a C corporation.

This recommendation is intended to be revenue neutral for the state. The intended effect of the PET is only to allow owners of pass-through entities to reduce their share of federal income tax liability, specifically as it relates to the SALT deduction. Furthermore, this recommendation is intended to minimize procedural changes and additional responsibilities for DFA. Finally, this proposal would be designed according to guidance received from and the requirements of the Internal Revenue Service.

Fiscal Analysis: According to DFA, there is no tax revenue cost to the state regarding collections under this recommendation; however, implementation of

this recommendation would require additional staffing and computer programming for DFA. Additional employees and processing costs would be approximately five hundred thousand dollars (\$500,000) per year with an additional cost for programming to create a new tax type within the integrated tax system.

C. Property Tax.

The following recommendations have been adopted by the Task Force with regard to property tax:

1. ***Business Inventory Tax Credit.*** The Task Force recommends creating a non-refundable income tax credit equal to the amount of property tax the taxpayer paid on business inventory, with a carry-forward period of ten (10) years. The income tax credit created under this recommendation and the tax deduction offered under Arkansas Code § 26-51-416 would be mutually exclusive, and business inventory that is exempt from property tax would not be subject to the income tax credit. Implementation of this recommendation would likely require changes at the county level to allow taxpayers to identify the portion of property tax paid that is eligible for the income tax credit, and taxpayers would be required to provide proof of payment of the property tax to claim the income tax credit. The income tax credit would be effective for tax years beginning on and after January 1, 2019.

Fiscal Analysis: According to the Arkansas Assessment Coordination Department (ACD), Arkansas collected an estimated seventy million two hundred ten thousand dollars (\$70,210,000) from ad valorem property tax levied on business inventory based on collections from 2016. According to DFA, depending on the nature of a tax credit or deduction to offset the ad valorem personal property tax paid on business inventory, such a tax credit or deduction may result in an estimated loss of general revenues of up to seventy million two hundred ten thousand dollars (\$70,210,000) based on collections from 2016.

2. ***Franchise Tax on Corporations.*** The Task Force recommends changing the filing date for the franchise tax, transferring the administration and collection authority for the franchise tax to DFA, and eliminating the franchise tax penalty on closed businesses.

Fiscal Analysis: According to DFA, transferring the corporate franchise tax to DFA – Office of Corporation Income Tax would require an additional three (3) to four (4) employees to oversee corporate franchise tax in conjunction with the corporate income tax and programming costs. One-time programming costs to add the franchise tax to DFA's computer system would be six hundred thirty thousand dollars (\$630,000), and ongoing costs for upkeep would be two hundred seventy thousand dollars (\$270,000). The Secretary of State's Office appropriation currently includes costs to administer the corporate franchise tax.

3. ***State Guidelines on Assessing Exempt Property.*** The Task Force recommends requiring the Assessment Coordination Department (ACD) to create statewide guidelines for the assessment of exempt property that are established by ACD and that counties are required to comply with. This recommendation would also give ACD the authority to oversee and enforce property tax laws and would require ACD to inform Legislative Council or the Joint Budget Committee concerning any non-compliant counties so that the Legislative Council or the Joint Budget Committee can determine whether to recommend to the General Assembly that the non-compliant county's turnback funds be reduced or withheld until the county becomes compliant.

Fiscal Analysis: DFA is unable to provide a fiscal or administrative impact on this proposal.

D. Excise and Miscellaneous Tax.

The following recommendations have been adopted by the Task Force with regard to excise and miscellaneous taxes:

1. ***Index Fuel Taxes.*** The Task Force recommends indexing motor fuel and distillate special fuel tax rates based on the inflation rate of construction costs, with the minimum tax rate set at the current tax rate and the maximum tax rate set at three percent (3%) over the tax rate of the previous year. Under this recommendation, the indexing of the motor fuel and distillate special fuel taxes would be structured to comply with the International Fuel Tax Agreement (IFTA).

Fiscal Analysis: Without specific guidance on the construction costs and how to adjust the motor fuel taxes, DFA is unable to provide a fiscal impact statement or analysis.

DFA could publish on a quarterly, biannual, or annual basis the amount of the adjustment to the motor fuel, distillate special fuel, and other related taxes based on a defined formula provided by legislation. The fiscal impact will be dependent on the inflationary measure chosen by the General Assembly. Additionally, the General Assembly should consider whether such an indexing could allow for a reduction in the motor fuel tax in certain circumstances.

2. ***Road User Fee for Electric and Hybrid Vehicles.*** The Task Force recommends creating a road user fee for electric and hybrid vehicles at the point of registration and using the resulting revenue for highway funding.

Fiscal Analysis: According to DFA, the average number of electric vehicles that are renewed each year based on the previous three (3) calendar years is three hundred ninety-one (391) per year, and the average number of hybrid vehicle registration renewals over the same period is fourteen thousand five hundred

(14,500). The total number of registered electric vehicles is one thousand three hundred eight (1,308), and the total number of registered hybrid motor vehicles is forty-one thousand two hundred fifty-two (41,252). These numbers have shown an increase over the past several years.

Based on DFA's fiscal analysis of HB2241 of 2017, which would have levied a registration fee of one hundred eighty-four dollars (\$184) on electric vehicles and ninety dollars (\$90) on hybrid vehicles, the fiscal impact would have been approximately one million eighty-two thousand six hundred thirty-four dollars (\$1,082,634). However, that fiscal impact was based on four hundred nineteen (419) electric vehicles and sixteen thousand three hundred forty (16,340) hybrid vehicles.

III. REMI – Dynamic Scoring.

On March 19, 2018, the Task Force authorized the BLR to enter into a contract with Regional Economic Models, Inc. (REMI) for the production of dynamic fiscal notes regarding tax reform and relief proposals submitted to REMI by the Task Force. The contract between the BLR and REMI was approved by the Legislative Council at its meeting on April 16, 2018.

The Task Force voted to send the following proposals to REMI for dynamic fiscal scoring at its June 26 meeting:

- **Individual Income Tax Brackets – “Option A”** (as described in Section II.B.5.a. of this report);
- **Individual Income Tax Brackets – “Option B” combined with an EITC** (as described in Section II.B.5.b. of this report);
- **Reduction of the Top Individual Income Tax Rate** (as described in Section II.B.5.c. of this report); and
- **Tax Foundation Suggested Tax Reform Package.** At the meeting of the Task Force on June 21, 2018, Ms. Nicole Kaeding with the Tax Foundation presented her suggested reforms for the Arkansas tax code.¹ From those recommendations, the Task Force sent the following to REMI for dynamic scoring:

Lowering the top individual income tax rate to 6.0%;
Lowering the top corporate income tax rate to 6.0%;
Repeal of the Throwback rule;
Single Sales Factor Apportionment;
Repeal of the Inventory Tax; and
Repeal of the Franchise Tax.

¹ *Arkansas Options for Tax Reform*, Nicole Kaeding, Tax Foundation, June 21, 2018, p. 15.

On August 6, 2018, representatives of REMI appeared before the Task Force to present the dynamic fiscal notes for the four (4) proposals sent to them. (See *Appendix A*, REMI Legislative Impact Statements).

A. Individual Income Tax Rate Proposals

With regard to the proposed revisions to individual income tax rates, REMI evaluated Option A, Option B combined with a refundable EITC, and the proposal to reduce the top individual income tax rate to 6.0% (the “Governor’s Proposal”) in an identical manner. The legislative impact statements for each individual income tax rate proposal utilized the following methodology:

fiscal, economic, and demographic estimates based on three different analytical approaches to evaluating the [proposals]: (1) assessing changes in business production costs; (2) assessing changes to disposable personal income; and (3) a blended approach taking both production costs and disposable personal income into consideration.

For each approach, two scenarios are simulated using a dynamic economic model – one based on tax cuts alone, and the other factoring in corresponding cuts to government spending given the sizable static decrease in revenue.²

This approach resulted in six (6) scenarios for each of the three individual income tax proposals.

1. REMI’s conclusions with regard to “**Option A**” were as follows:³

- Production-Cost Approach:

“[R]eflects the potential for tax cuts to cause a reduction in costs for businesses, which in turn affect the economy in ways that an income-only approach may not capture. Since Option A would affect after-tax wages and salaries, the plan would change the competitive position of Arkansas-based employers seeking to attract workers. Employers in the state have to compensate for the tax burden in order to compete with employers based in lower-tax states.

The production-cost approach shows annual economic output growing on average over 5 years by \$421.4 million and an average annual increase of 3,267 jobs, with more than 92 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$271.5 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would

² *Legislative Impact Statements*, Peter Evangelakis, Ph.D., Senior Economist, REMI, Governor’s Proposal, Executive Summary, p. 1; Option A, Executive Summary, p. 1; and Option B, Executive Summary, p. 1.

³ *Legislative Impact Statements*, Peter Evangelakis, Ph.D., Senior Economist, REMI, Option A, p. 16.

be concentrated in the public sector while the private sector would gain jobs.”

- Income-Focused Approach:
“[S]hows annual economic output growing on average over 5 years by \$310.7 million and an average annual increase of 2,446 jobs, with 90 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$268.3 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would be mostly concentrated in the public sector.”
 - Blended Approach:
“[S]hows annual economic output growing on average over 5 years by \$321.9 million and an average annual increase of 2,528 jobs, with more than 90 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$268.6 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would be mostly concentrated in the public sector.”
2. REMI’s conclusions with regard to **“Option B” combined with a refundable EITC** were as follows:⁴

- Production-Cost Approach:
“[R]eflects the potential for tax cuts to cause a reduction in costs for businesses, which in turn affect the economy in ways that an income-only approach may not capture. Since Option B and the EITC would affect after-tax wages and salaries, the plan would change the competitive position of Arkansas-based employers seeking to attract workers. Employers in the state have to compensate for the tax burden in order to compete with employers based in lower-tax states.

The production-cost approach shows annual economic output growing on average over 5 years by \$313.5 million and an average annual increase of 2,430 jobs, with more than 92 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$202.6 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would be concentrated in the public sector while the private sector would gain jobs.”

- Income-Focused Approach:
“[S]hows annual economic output growing on average over 5 years by \$231.3 million and an average annual increase of 1,820 jobs, with over 90

⁴ *Legislative Impact Statements*, Peter Evangelakis, Ph.D., Senior Economist, REMI, Option B, p. 16.

percent of the growth occurring in private non-farm employment. It also shows a net loss of \$200.2 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would be mostly concentrated in the public sector.”

- Blended Approach:
“[S]hows annual economic output growing on average over 5 years by \$239.6 million and an average annual increase of 1,882 jobs, with more than 90 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$200.4 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would be mostly concentrated in the public sector.”

3. REMI’s conclusions with regard to the “**Governor’s Proposal**” were as follows:⁵

- Production-Cost Approach:
“[R]eflects the potential for tax cuts to cause a reduction in costs for businesses, which in turn affect the economy in ways that an income-only approach may not capture. Since the Governor’s Proposal would affect after-tax wages and salaries, the plan would change the competitive position of Arkansas-based employers seeking to attract workers. Employers in the state have to compensate for the tax burden in order to compete with employers based in lower-tax states.

The production-cost approach shows annual economic output growing on average over 5 years by \$274.0 million and an average annual increase of 2,124 jobs, with more than 92 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$176.8 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would be concentrated in the public sector while the private sector would gain jobs.”

- Income-Focused Approach:
“[S]hows annual economic output growing on average over 5 years by \$202.4 million and an average annual increase of 1,593 jobs, with 90 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$174.7 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would be mostly concentrated in the public sector.”

⁵ *Legislative Impact Statements*, Peter Evangelakis, Ph.D., Senior Economist, REMI, Governor’s Proposal, p. 15.

- **Blended Approach:**
“[S]hows annual economic output growing on average over 5 years by \$239.6 million and an average annual increase of 1,882 jobs, with more than 90 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$200.4 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would be mostly concentrated in the public sector.”

Overall, the dynamic scoring results for each proposal with regard to revenue loss showed a difference of roughly six percent (6%) between the net revenue loss in the dynamic analyses by REMI and the static fiscal impacts provided by DFA.

REMI then conducted a separate dynamic fiscal analysis for the remaining components of the Tax Foundation’s proposals. For each of the following proposals, REMI ran only a single scenario:

B. Corporate Income Tax Proposal

This proposal would reduce the top corporate income tax rate from 6.5% to 6.0%. REMI stated in its conclusion that the “results show annual economic output growing on average over 5 years by \$46.3 million and an average annual increase of 356 jobs, with more than 93 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$30.8 million in revenue.”⁶

C. Throwback Rule

This proposal would repeal the throwback rule for multistate business income under Arkansas Code § 26-51-716, effective for tax years beginning January 1, 2019. REMI’s dynamic fiscal analysis results “show annual economic output growing on average over 5 years by \$28.7 million and an average annual increase of 152 jobs, with more than 92 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$24.5 million in revenue.”⁷

D. Single Sales Factor Apportionment

This proposal would amend the apportionment formula for taxing multistate business income to use a single sales factor apportionment, effective for tax years beginning January 1, 2019. REMI’s dynamic fiscal analysis results “show annual economic output falling on average over 5 years by \$13.8 million and an average annual

⁶ *Legislative Impact Statements*, Peter Evangelakis, Ph.D., Senior Economist, REMI, Corporate Income Tax Proposal, p. 2.

⁷ *Legislative Impact Statements*, Peter Evangelakis, Ph.D., Senior Economist, REMI, Throwback Rule Repeal Proposal, p. 2.

decrease of 94 jobs, with more than 91 percent of the decline occurring in private non-farm employment. It also shows a net increase of \$8.6 million in revenue.”⁸

E. Inventory Tax

The proposal analyzed was a repeal of the business inventory tax. REMI’s dynamic fiscal analysis results “show annual economic output growing on average over 5 years by \$88.1 million and an average annual increase of 488 jobs, with more than 91 percent of the growth occurring in private non-farm employment. It also shows a net gain of \$2.8 million in state revenue.”⁹

F. Franchise Tax

The proposal analyzed was a repeal of the franchise tax. In analyzing this proposal, REMI did so “in combination with a decrease in general state government expenditures to model the scenario in which the lost education funding is made up elsewhere in the state budget.” The loss in education funding was estimated to be \$21 million. REMI’s dynamic fiscal results “show annual economic output falling on average over 5 years by \$9.1 million and an average annual decrease of 149 jobs, but a small increase in private non-farm employment. It also shows a net loss of \$29.3 million in revenue.”¹⁰

IV. Task Force Priorities.

In June 2018, the members of the Task Force were asked to determine their priorities with regard to formulating a \$200 million tax reform and relief package. (See *Appendix B*, sample \$200 million Priorities Worksheet). The rankings provided by the members were analyzed by Richard Wilson, Assistant Director, Research Services Division, BLR, in order to determine the overall priorities for the Task Force. (See *Appendix C*, \$200 million Priorities Spreadsheet). The analysis of the members’ priority rankings indicated that the Task Force’s top four (4) priorities were:

1. Repeal of the Throwback Rule combined with Single Sales Factor Apportionment;
2. Simplification of the Individual Income Tax Brackets and Tables under “Option A” (as set forth above);
3. Incremental Increase of the Carry-Forward Period for Net Operating Losses; and
4. Lowering the top rates for Individual and Corporate Income Tax.

⁸ *Legislative Impact Statements*, Peter Evangelakis, Ph.D., Senior Economist, REMI, Single Sales Factor Proposal, p. 3.

⁹ *Legislative Impact Statements*, Peter Evangelakis, Ph.D., Senior Economist, REMI, Inventory Tax Repeal Proposal, p. 2.

¹⁰ *Legislative Impact Statements*, Peter Evangelakis, Ph.D., Senior Economist, REMI, Franchise Tax Repeal Proposal, p. 3.

At its August 7, 2018 meeting, the members were asked to complete a revenue increase worksheet to show their priorities (from 1 to 6) with regard to elimination of certain exemptions or deductions, collection of sales and use tax from new sources, and creation of excise taxes or fees. (See *Appendix D*, sample Revenue Increase Worksheet). The rankings were analyzed by Richard Wilson, and the priorities fell as follows (See *Appendix E*, Revenue Priorities Table):

1. Collection of Sales and Use Tax by Remote Sellers;
2. Repeal of the Capital Gains Tax Exemption over \$10 million;
3. Repeal of the Income Tax Credit for Political Contributions;
4. Creation of a Road User Fee for Electric and Hybrid Vehicles;
5. Repeal of the Sales Tax Exemption for Magazine Subscriptions; and
6. Indexing Motor Fuel and Distillate Special Fuel Taxes.

V. Conclusion.

As it continues its work of formulating a tax reform and relief package, the Task Force will meet regularly throughout the remainder of 2018. The Task Force's next step is to analyze its adopted recommendations with regard to the revenue impacts and the possibilities of any offsets of those impacts through recommendations that repeal exemptions or tax credits or that create new fees or excise taxes. The Task Force will examine the feasibility of tax triggers or other phase-in options for its plan in order to minimize the impact to the state's budget due to revenue loss resulting from proposed tax cuts.

The Task Force is working toward the introduction of legislation during the 2019 legislative session and will begin proposing and discussing bill drafts in the coming weeks. Throughout this process, the Task Force will continue to request input from the BLR, DFA, the Tax Foundation, ITEP, and REMI, in order to ensure that it has all relevant analyses of its proposed legislation. It is the intention of the Task Force to strive to fulfill its mandate under the Act to identify areas of potential reform within the Arkansas tax code in order to make Arkansas competitive with surrounding states, bring business and jobs to the state, and provide fairness and relief to the taxpayers of Arkansas.

VI. Appendices.

- A.** REMI Legislative Impact Statements
- B.** \$200 Million Priorities Worksheet
- C.** \$200 Million Priorities Spreadsheet
- D.** Revenue Increase Priorities Worksheet
- E.** Revenue Increase Priorities Table

Appendix A

Summary Statements: Proposals sent for Dynamic Scoring *Arkansas Tax Reform and Relief Legislative Task Force*

The Task Force voted to send the following proposals to Regional Economic Models, Inc. (REMI) for dynamic fiscal scoring at its June 26 meeting. REMI will provide its dynamic fiscal notes on these four proposals at the August 6, 2018 meeting of the Task Force.

1. **Individual Income Tax Brackets – “Option A”.** This proposal recommends amending and simplifying the Arkansas individual income tax rates and brackets under Arkansas Code § 26-51-201, effective for tax years beginning January 1, 2019. This would be accomplished by reducing the number of individual income tax tables from three (3) to one (1) and reducing the top marginal rate for individuals from six and nine-tenths percent (6.9%) to six and five-tenths percent (6.5%). The individual income tax table under this recommendation would be as follows:

Individual Income Tax Bracket	Tax Rate
\$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+	6.5%

2. **Individual Income Tax Brackets – “Option B” combined with an EITC.** This proposal would reduce the number of individual income tax tables from three (3) to one (1) and reduce the top marginal rate for individuals from six and nine-tenths percent (6.9%) to six and five-tenths percent (6.5%). The individual income tax table under Option B would be as follows:

Option B	
Individual Income Tax Bracket	Tax Rate
\$0-\$4,299	0.9%
\$4,300 - \$8,399	2.4%
\$8,400 - \$12,599	3.4%
\$12,600 - \$20,999	4.4%
\$21,000 - \$35,099	5.0%
\$35,100 - \$80,000	6.0%
\$80,000+	6.5%

The fiscal impact of the simplification of the individual income tax brackets and tables under this proposal will be analyzed by REMI as combined with a Refundable Earned Income Tax Credit (EITC) of ten percent (10%) of the Federal EITC.

3. ***Reduction of the Top Individual Income Tax Rate.*** This proposal would reduce the top personal income tax rate from 6.9% to 6.0% but would not affect the rate in any of the other brackets.
4. ***Tax Foundation Suggested Tax Reform Package.*** At the meeting of the Task Force on June 21, 2018, Ms. Nicole Kaeding with the Tax Foundation presented her suggested reforms for the Arkansas tax code.¹ From those recommendations, the Task Force sent the following to REMI for dynamic scoring:
 - Lowering the top individual income tax rate to 6.0%;
 - Lowering the top corporate income tax rate to 6.0%;
 - Repeal of the Throwback rule;
 - Single Sales Factor Apportionment;
 - Repeal of the Inventory Tax; and
 - Repeal of the Franchise Tax.

¹ *Arkansas Options for Tax Reform*, Nicole Kaeding, Tax Foundation, June 21, 2018, p. 15.

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Proposals Under Consideration: Income Tax Proposal – Option A

Executive Summary:

Three proposals under consideration amend and simplify the Arkansas individual income tax rates and brackets under Arkansas Code § 26-51-201, effective for tax years beginning January 1, 2019. This impact statement focuses on the proposal titled "Option A".

Option A reduces the number of individual income tax tables from three (3) to one (1) and reduces the top marginal rate for individuals from six and nine-tenths percent (6.9%) to six and five-tenths percent (6.5%). The individual income tax table under Option A is as follows:

Option A	
Individual Income Tax Bracket	Tax Rate
\$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+	6.5%

Option A reduces Arkansas' state income tax revenue by \$276,437,336, based on a static impact analysis. The static estimate does not include the total macroeconomic effects of how consumers and business respond to the policy change.

This impact statement includes fiscal, economic, and demographic estimates based on three different analytical approaches to evaluating Option A: (1) assessing changes in business production costs; (2) assessing changes to disposable personal income; and (3) a blended approach taking both production costs and disposable personal income into consideration.

For each approach, two scenarios are simulated using a dynamic economic model – one based on tax cuts alone, and the other factoring in corresponding cuts to government spending given the sizable static decrease in revenue. A dynamic model captures the macroeconomic feedback from behavioral changes among consumers and businesses and allows this to have feedback effects on state revenues and expenditures.

The production-based approach accounts for the connection between tax cuts and the lower cost of doing business in the state. Specifically, reduced taxes translate into higher after-tax salaries, which allows employers to compete for workers without having to pay more in salaries.

Major Arkansas-based companies must now compete for workers with companies in states with lower or no income taxes. To compensate for higher taxes, employers have to offer higher salaries, which increases production costs. A tax cut, on the other hand, could attract in-migration due to the higher after-tax compensation while lowering costs for employers.

Not all employers can choose to locate in a state based on taxation. While some major employers sell their goods and services across the country and internationally, other businesses (auto mechanics, restaurants, etc.) locate based on proximity to customers. The macroeconomic analysis within this dynamic fiscal note accounts for economic migration due to changes in business conditions and anticipated after-tax disposable personal income.

The blended approach shows annual economic output growing on average over 5 years by \$321.9 million and

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Proposals Under Consideration: Income Tax Proposal – Option A

an average annual increase of 2,528 jobs, with more than 90 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$268.6 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would be mostly concentrated in the public sector.

The production-cost approach shows annual economic output growing on average over 5 years by \$421.4 million and an average annual increase of 3,267 jobs, with more than 92 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$271.5 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would be concentrated in the public sector while the private sector would gain jobs.

The income-focused approach shows annual economic output growing on average over 5 years by \$310.7 million and an average annual increase of 2,446 jobs, with 90 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$268.3 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would be mostly concentrated in the public sector.

Methodology:

The economic and fiscal analysis of the proposals is conducted by Regional Economic Models, Inc. (REMI) using their Tax-PI v2.1 software, which is a dynamic regional macroeconomic, demographic, and fiscal model. Specifically, they use a 1-region custom model of Arkansas that is calibrated to revenues and expenditures from the FY 2017 Arkansas state budget.

Each budget category was assigned both an "economic driver" that allows it to respond to changes in a specific economic variable (e.g., Personal Income for Personal Income Tax Revenue) and a "policy variable" that allows it to directly impact a specific economic variable (e.g., Production Cost for Personal Income Tax Revenue).

The relatively large decrease in personal income taxes and recent changes in federal income tax law merit a sensitivity analysis consisting of six scenarios.

Scenarios Reflecting Range of Outcomes from REMI Tax-PI Dynamic Fiscal Analysis

- 1) Both direct personal income tax and business cost decreases with no reduction in general state government expenditures
- 2) Both direct personal income tax and business cost decreases with equal reduction in general state government expenditures
- 3) Business cost decrease with no direct reduction in general state government expenditures
- 4) Business cost decrease with equal direct reduction in general state government expenditures
- 5) Direct personal income tax decrease with no direct reduction in general state government expenditures
- 6) Direct personal income tax decrease with equal direct reduction in general state government expenditures

Scenarios 1 and 2 reflect the impacts of reductions in personal income taxes on both employees and business owners across the state of Arkansas, a blended approach based on publicly available data. Specifically, Scenarios 1 and 2 assume that approximately 90% of the personal income tax reductions directly benefit

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Proposals Under Consideration: Income Tax Proposal – Option A

employees or non-business owners and approximately 10% reduces costs of doing business.¹ Scenarios 3 and 4 reflect 100% of the personal income taxes being passed on to business owners through lower costs of doing business. Scenarios 5 and 6 reflect 100% of the personal income tax reductions being enjoyed by employees and non-business owners. The even numbered scenarios (2, 4, and 6) include an equal reduction in direct government expenditures.

For each proposal, the static income tax revenue impact and the resulting direct economic shock are input into the model for each year during the 5-year period 2019-2023. Then, the model produces estimates for each proposal of economic impacts on the state of Arkansas such as employment, GDP, output, and disposable personal income, demographic impacts on the state such as changes in population, and fiscal impacts on the state budget including both revenues and expenditures.

The results for Option A are reported in the next section with accompanying discussion.

Economic & Fiscal Impacts:

The economic and fiscal impacts of Option A are evaluated using six different scenarios.

Scenario 1

The first scenario follows the blended approach, accounting for both a direct personal income tax decrease and lower business costs, where the mix between the two is based on a ratio of state earnings by source.

The annual **increase** in Arkansas' population rises from **1,642** in 2019 to **5,223** in 2023, with a 5-year average annual **increase** of **3,700**. This is largely driven by higher after-tax compensation rates and employment opportunities, both of which raise the level of economic in-migration.

Total employment **rises** by an average of **2,528**, of which **90.3%** comes from private non-farm sectors and **9.7%** comes from the government sector. Additionally, Gross State Product (GSP) and total output (which accounts for both GSP as well as the value of intermediate inputs) **increase** by an average of **\$194.4 million** and **\$321.9 million**, respectively. This increase in economic activity is driven mainly by three key factors: (1) the influx of new population; (2) the increase in disposable personal income generated by lower personal income taxes; and (3) the decrease in business costs which makes Arkansas industries more competitive with imports. Disposable personal income **increases** by an average of **\$405.4 million**.

The static impact of the tax cut is a **\$276.4 million loss** in state revenue per year, but the increase in economic activity partially offsets the loss. Thus, the total revenue **loss** averages **\$261.1 million**. This means that **5.5%** of the static revenue loss is recovered. The dynamic income tax revenue impact by bracket is:

¹ Personal income tax filings data are confidential and the responses within the Arkansas economy may not directly represent historic filing income distribution weights by personal income category or business ownership type.

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Proposals Under Consideration: Income Tax Proposal – Option A

S1 - Dynamic Personal Income Tax Revenue Impact by Income Bracket

Income Bracket	Units	2019	2020	2021	2022	2023	Average
\$0 - \$4,299	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$4,300 - \$8,399	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$8,400 - \$12,599	Nominal Millions	\$0.01	\$0.01	\$0.01	\$0.01	\$0.01	\$0.01
\$12,600 - \$20,999	Nominal Millions	\$0.06	\$0.08	\$0.09	\$0.10	\$0.10	\$0.08
\$21,000 - \$35,099	Nominal Millions	\$0.22	\$0.29	\$0.34	\$0.37	\$0.38	\$0.32
\$35,100 - \$80,000	Nominal Millions	\$0.70	\$0.95	\$1.10	\$1.18	\$1.21	\$1.03
\$80,000+	Nominal Millions	\$1.60	\$2.15	\$2.50	\$2.68	\$2.74	\$2.33

Largely as a result of the increase in population and GDP, state government expenditures rise by an average of \$7.5 million.

The results shown below are differences from the baseline REMI forecast.

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Proposals Under Consideration: Income Tax Proposal – Option A

S1 - Direct Personal Income Tax Decrease & Private Non-Farm Production Cost Decrease							
Results	Units	2019	2020	2021	2022	2023	Average
Population	Individuals	1,642	2,948	3,973	4,717	5,223	3,700
Total Employment	Individuals	2,200	2,604	2,719	2,637	2,480	2,528
Government Employment	Individuals	134	218	269	294	304	244
Private Non-Farm Employment	Individuals	2,066	2,386	2,449	2,342	2,177	2,284
Gross State Product (Value-Added)	Nominal Millions	\$157.5	\$192.6	\$207.9	\$209.6	\$204.4	\$194.4
Output (Industry Sales)	Nominal Millions	\$262.1	\$320.2	\$344.6	\$346.1	\$336.3	\$321.9
Disposable Personal Income	Nominal Millions	\$354.7	\$392.5	\$416.4	\$429.3	\$434.0	\$405.4
Government Revenue	Nominal Millions	-\$264.2	-\$262.0	-\$260.5	-\$259.7	-\$259.3	-\$261.1
Government Expenditure	Nominal Millions	\$3.1	\$5.8	\$8.0	\$9.6	\$10.8	\$7.5
NET REVENUE (Gov Rev, less Gov Exp)	Nominal Millions	-\$267.3	-\$267.8	-\$268.5	-\$269.3	-\$270.1	-\$268.6

Scenario 2

The second scenario also follows the blended approach, accounting for both a direct personal income tax decrease and lower business costs, where the mix between the two is based on a ratio of state earnings by source. In addition, this scenario accounts for a cut in general state government expenditures equal to the size of the personal income tax cut.

The annual **decrease** in Arkansas' population rises from **89** in 2019 to **281** in 2023, with a 5-year average annual **decrease** of **182**. This is largely driven by lower employment opportunities, which lowers the level of economic in-migration.

Total employment **falls** by an average of **2,228**, of which **10.9%** comes from private non-farm sectors and **89.1%** comes from the government sector. Additionally, Gross State Product (GSP) and total output (which accounts for both GSP as well as the value of intermediate inputs) **decrease** by an average of **\$150.9 million** and **\$252.8 million**, respectively. This decrease in economic activity is driven mainly by two key factors: (1) the decrease in population; and (2) the decrease in government expenditures. Disposable personal income **increases** by an average of **\$137.1 million**.

The static impact of the tax cut is a **\$276.4 loss** in state revenue per year, and the change in economic activity does not materially affect the size of this loss. Thus, the total revenue **loss** averages **\$276.4 million**. This means that **0.0%** of the static revenue loss is recovered. The dynamic income tax revenue impact by bracket

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Proposals Under Consideration: Income Tax Proposal – Option A

is:

S2 - Dynamic Personal Income Tax Revenue Impact by Income Bracket

Income Bracket	Units	2019	2020	2021	2022	2023	Average
\$0 - \$4,299	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$4,300 - \$8,399	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$8,400 - \$12,599	Nominal Millions	-\$0.01	-\$0.01	-\$0.01	-\$0.01	-\$0.01	-\$0.01
\$12,600 - \$20,999	Nominal Millions	-\$0.06	-\$0.06	-\$0.06	-\$0.06	-\$0.07	-\$0.06
\$21,000 - \$35,099	Nominal Millions	-\$0.22	-\$0.22	-\$0.23	-\$0.24	-\$0.25	-\$0.23
\$35,100 - \$80,000	Nominal Millions	-\$0.71	-\$0.71	-\$0.74	-\$0.77	-\$0.81	-\$0.75
\$80,000+	Nominal Millions	-\$1.60	-\$1.62	-\$1.68	-\$1.76	-\$1.84	-\$1.70

Largely as a result of the decrease in population and GDP, state government expenditures **decrease** by an average of \$3.9 million over and above the \$276.4 million **decrease** in expenditures corresponding with the tax cut for a total **decrease** of \$280.3 million. Thus, the average annual change in net revenue is an **increase** of \$3.8 million.

The results shown below are differences from the baseline REMI forecast.

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Proposals Under Consideration: Income Tax Proposal – Option A

S2 - Direct Personal Income Tax Decrease & Private Non-Farm Production Cost Decrease with Direct State Expenditure Decrease

Results	Units	2019	2020	2021	2022	2023	Average
Population	Individuals	-89	-137	-177	-227	-281	-182
Total Employment	Individuals	-2,582	-2,294	-2,158	-2,078	-2,030	-2,228
Government Employment	Individuals	-2,093	-2,041	-1,990	-1,930	-1,877	-1,986
Private Non-Farm Employment	Individuals	-488	-253	-169	-148	-153	-242
Gross State Product (Value-Added)	Nominal Millions	-\$167.7	-\$151.3	-\$145.7	-\$144.5	-\$145.4	-\$150.9
Output (Industry Sales)	Nominal Millions	-\$286.0	-\$255.9	-\$243.9	-\$239.6	-\$238.6	-\$252.8
Disposable Personal Income	Nominal Millions	\$143.3	\$142.5	\$138.4	\$133.3	\$127.8	\$137.1
Government Revenue	Nominal Millions	-\$276.3	-\$276.2	-\$276.3	-\$276.6	-\$276.8	-\$276.4
Government Expenditure	Nominal Millions	-\$278.1	-\$279.4	-\$280.4	-\$281.3	-\$282.1	-\$280.3
NET REVENUE (Gov Rev, less Gov Exp)	Nominal Millions	\$1.8	\$3.2	\$4.1	\$4.8	\$5.3	\$3.8

Scenario 3

The third scenario treats 100% of the personal income tax cut as a decrease in business costs.

The annual **increase** in Arkansas' population rises from 1,117 in 2019 to 5,022 in 2023, with a 5-year average annual **increase** of 3,181. This is largely driven by higher employment opportunities, which raises the level of economic in-migration.

Total employment **rises** by an average of 3,267, of which 92.6% comes from private non-farm sectors and 7.4% comes from the government sector. Additionally, Gross State Product (GSP) and total output (which accounts for both GSP as well as the value of intermediate inputs) increase by an average of **\$242.3 million** and **\$421.4 million**, respectively. This **increase** in economic activity is driven mainly by two key factors: (1) the influx of new population; and (2) the decrease in business costs which makes Arkansas industries more competitive with imports. Disposable personal income **increases** by an average of **\$175.7 million**.

The static impact of the tax cut is a **\$276.4 million loss** in state revenue per year, but the increase in economic activity partially offsets the loss. Thus, the total revenue **loss** averages **\$264.4 million**. This means that 4.3% of the static revenue loss is recovered. The dynamic income tax revenue impact by bracket is:

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Proposals Under Consideration: Income Tax Proposal – Option A

S3 - Dynamic Personal Income Tax Revenue Impact by Income Bracket

Income Bracket	Units	2019	2020	2021	2022	2023	Average
\$0 - \$4,299	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$4,300 - \$8,399	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$8,400 - \$12,599	Nominal Millions	\$0.00	\$0.01	\$0.01	\$0.01	\$0.01	\$0.01
\$12,600 - \$20,999	Nominal Millions	\$0.05	\$0.08	\$0.10	\$0.12	\$0.13	\$0.09
\$21,000 - \$35,099	Nominal Millions	\$0.18	\$0.29	\$0.38	\$0.45	\$0.50	\$0.36
\$35,100 - \$80,000	Nominal Millions	\$0.59	\$0.93	\$1.22	\$1.44	\$1.61	\$1.16
\$80,000+	Nominal Millions	\$1.34	\$2.12	\$2.76	\$3.28	\$3.66	\$2.63

Largely as a result of the increase in population, state government expenditures rise by an average of \$7.1 million.

The results shown below are differences from the baseline REMI forecast.

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Proposals Under Consideration: Income Tax Proposal – Option A

S3 - Direct Private Non-Farm Production Cost Decrease							
Results	Units	2019	2020	2021	2022	2023	Average
Population	Individuals	1,117	2,237	3,297	4,235	5,022	3,181
Total Employment	Individuals	2,096	2,949	3,505	3,814	3,969	3,267
Government Employment	Individuals	102	189	260	311	348	242
Private Non-Farm Employment	Individuals	1,994	2,760	3,245	3,503	3,621	3,025
Gross State Product (Value-Added)	Nominal Millions	\$140.1	\$207.1	\$256.6	\$291.7	\$315.7	\$242.3
Output (Industry Sales)	Nominal Millions	\$242.7	\$360.6	\$446.9	\$507.6	\$549.0	\$421.4
Disposable Personal Income	Nominal Millions	\$89.1	\$141.0	\$184.2	\$219.0	\$245.1	\$175.7
Government Revenue	Nominal Millions	-\$269.5	-\$266.5	-\$263.9	-\$261.8	-\$260.2	-\$264.4
Government Expenditure	Nominal Millions	\$2.3	\$4.8	\$7.3	\$9.6	\$11.6	\$7.1
NET REVENUE (Gov Rev, less Gov Exp)	Nominal Millions	-\$271.8	-\$271.3	-\$271.2	-\$271.4	-\$271.8	-\$271.5

Scenario 4

The fourth scenario also treats 100% of the personal income tax cut as a decrease in business costs. In addition, this scenario accounts for a cut in general state government expenditures equal to the size of the personal income tax cut.

The annual **decrease** in Arkansas' population falls from **617** in 2019 to **489** in 2023, with a 5-year average annual **decrease** of **706**. This is largely driven by lower employment opportunities, which lowers the level of economic in-migration.

Employment in the private non-farm sectors **increases** annually over the next 5 years by an average of **494** jobs while government sector employment **declines** by an average of **1,988** jobs, creating an average total employment **decline** of **1,494** jobs. Additionally, Gross State Product (GSP) and Total Output (which accounts for both GSP as well as the value of intermediate inputs) decline by an average of **\$103.4 million** and **\$153.8 million**, respectively. This decline in economic activity is driven mainly by two key factors: (1) the decline in population; and (2) a decrease in disposable personal income caused by a decline in government employment. Disposable personal income **decreases** by an average of **\$92.9 million**.

The static impact of the tax cut is a **\$276.4 million loss** in state revenue per year, and the decrease in economic activity generates an additional loss. Thus, the total revenue loss averages **\$279.7 million**. This means that the static revenue loss is **increased** by another **1.2%**. The dynamic income tax revenue impact by

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Proposals Under Consideration: Income Tax Proposal – Option A

bracket is:

S4 - Dynamic Personal Income Tax Revenue Impact by Income Bracket

Income Bracket	Units	2019	2020	2021	2022	2023	Average
\$0 - \$4,299	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$4,300 - \$8,399	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$8,400 - \$12,599	Nominal Millions	-\$0.01	-\$0.01	\$0.00	\$0.00	\$0.00	\$0.00
\$12,600 - \$20,999	Nominal Millions	-\$0.07	-\$0.06	-\$0.05	-\$0.04	-\$0.03	-\$0.05
\$21,000 - \$35,099	Nominal Millions	-\$0.26	-\$0.23	-\$0.20	-\$0.16	-\$0.13	-\$0.19
\$35,100 - \$80,000	Nominal Millions	-\$0.82	-\$0.73	-\$0.63	-\$0.51	-\$0.41	-\$0.62
\$80,000+	Nominal Millions	-\$1.86	-\$1.65	-\$1.42	-\$1.17	-\$0.93	-\$1.41

Largely as a result of the decrease in population and GDP, state government expenditures **decrease** by an average of **\$4.2 million** over and above the **\$276.4 million decrease** in expenditures corresponding with the tax cut for a total decrease of **\$280.6 million**. Thus, the average annual change in net revenue is an increase of approximately **\$900,000**.

The results shown below are differences from the baseline REMI forecast.

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Proposals Under Consideration: Income Tax Proposal – Option A

S4 - Direct Private Non-Farm Production Cost Decrease with Direct State Expenditure Decrease							
Results	Units	2019	2020	2021	2022	2023	Average
Population	Individuals	-617	-852	-858	-714	-489	-706
Total Employment	Individuals	-2,689	-1,953	-1,377	-905	-547	-1,494
Government Employment	Individuals	-2,125	-2,070	-2,000	-1,914	-1,833	-1,988
Private Non-Farm Employment	Individuals	-563	117	622	1,009	1,286	494
Gross State Product (Value-Added)	Nominal Millions	-\$185.3	-\$137.1	-\$97.3	-\$62.8	-\$34.5	-\$103.4
Output (Industry Sales)	Nominal Millions	-\$305.8	-\$216.1	-\$142.2	-\$78.6	-\$26.6	-\$153.8
Disposable Personal Income	Nominal Millions	-\$122.5	-\$109.2	-\$94.1	-\$77.3	-\$61.4	-\$92.9
Government Revenue	Nominal Millions	-\$281.6	-\$280.6	-\$279.7	-\$278.7	-\$277.7	-\$279.7
Government Expenditure	Nominal Millions	-\$278.9	-\$280.4	-\$281.1	-\$281.3	-\$281.3	-\$280.6
<u>NET REVENUE</u> (Gov Rev, less Gov Exp)	Nominal Millions	-\$2.7	-\$0.3	\$1.4	\$2.7	\$3.5	\$0.9

Scenario 5

The fifth scenario treats 100% of the personal income tax cut as a direct decrease in personal income taxes.

The annual **increase** in Arkansas' population rises from 1,700 in 2019 to 5,246 in 2023, with a 5-year average annual **increase** of 3,758. This is largely driven by higher after-tax compensation rates raising the level of economic in-migration.

Total employment **rises** by an average of 2,446, of which 90.0% comes from private non-farm sectors and 10.0% comes from the government sector. Additionally, Gross State Product (GSP) and total output (which accounts for both GSP as well as the value of intermediate inputs) increase by an average of \$189.1 million and \$310.7 million, respectively. This increase in economic activity is driven mainly by two key factors: (1) the influx of new population; and (2) the increase in disposable personal income generated by lower personal income taxes. Specifically, disposable personal income **increases** by an average of \$431.1 million.

The static impact of the tax cut is a \$276.4 million **loss** in state revenue per year, but the increase in economic activity partially offsets the loss. Thus, the total revenue **loss** averages \$260.8 million. This means that 5.6% of the static revenue loss is recovered. The dynamic income tax revenue impact by bracket is:

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Proposals Under Consideration: Income Tax Proposal – Option A

S5 - Dynamic Personal Income Tax Revenue Impact by Income Bracket

Income Bracket	Units	2019	2020	2021	2022	2023	Average
\$0 - \$4,299	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$4,300 - \$8,399	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$8,400 - \$12,599	Nominal Millions	\$0.01	\$0.01	\$0.01	\$0.01	\$0.01	\$0.01
\$12,600 - \$20,999	Nominal Millions	\$0.06	\$0.08	\$0.09	\$0.09	\$0.09	\$0.08
\$21,000 - \$35,099	Nominal Millions	\$0.22	\$0.30	\$0.34	\$0.36	\$0.36	\$0.32
\$35,100 - \$80,000	Nominal Millions	\$0.72	\$0.95	\$1.09	\$1.15	\$1.16	\$1.01
\$80,000+	Nominal Millions	\$1.62	\$2.16	\$2.47	\$2.62	\$2.64	\$2.30

Largely as a result of the increase in population and GDP, state government expenditures rise by an average of \$7.5 million.

The results shown below are differences from the baseline REMI forecast.

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S5 - Direct Personal Income Tax Decrease

Results	Units	2019	2020	2021	2022	2023	Average
Population	Individuals	1,700	3,027	4,048	4,771	5,246	3,758
Total Employment	Individuals	2,212	2,566	2,631	2,505	2,314	2,446
Government Employment	Individuals	137	222	270	292	299	244
Private Non-Farm Employment	Individuals	2,074	2,344	2,360	2,213	2,016	2,201
Gross State Product (Value-Added)	Nominal Millions	\$159.5	\$191.0	\$202.5	\$200.4	\$191.9	\$189.1
Output (Industry Sales)	Nominal Millions	\$264.3	\$315.7	\$333.2	\$328.0	\$312.5	\$310.7
Disposable Personal Income	Nominal Millions	\$384.5	\$420.6	\$442.3	\$452.9	\$455.1	\$431.1
Government Revenue	Nominal Millions	-\$263.6	-\$261.5	-\$260.2	-\$259.5	-\$259.2	-\$260.8
Government Expenditure	Nominal Millions	\$3.2	\$5.9	\$8.0	\$9.6	\$10.7	\$7.5
NET REVENUE (Gov Rev, less Gov Exp)	Nominal Millions	-\$266.8	-\$267.4	-\$268.2	-\$269.1	-\$269.9	-\$268.3

Scenario 6

The sixth scenario also treats 100% of the personal income tax cut as a direct decrease in personal income taxes. In addition, this scenario accounts for a cut in general state government expenditures equal to the size of the personal income tax cut.

The annual **decline** in Arkansas' population **rises** from 31 in 2019 to 257 in 2023, with a 5-year average annual **decrease** of 124. This is largely driven by higher after-tax compensation rates raising the level of economic in-migration.

Total employment **decreases** by an average of 2,310, of which 14.0% comes from private non-farm sectors and 86.0% comes from the government sector. Additionally, Gross State Product (GSP) and total output (which accounts for both GSP as well as the value of intermediate inputs) **decrease** by an average of \$156.2 million and \$263.9 million, respectively. This **decrease** in economic activity is driven mainly by the **decrease** in in-state consumption that comes from two key factors: (1) the decrease in population; and (2) a portion of consumers' increased after-tax income being spent on out-of-state goods and services. Specifically, disposable personal income will **increase** by an average of \$162.8 million.

The static impact of the tax cut is a \$276.4 million loss in state revenue per year, but the increase in economic activity created by the increase in consumer after-tax personal income generates an average increase in annual revenue of \$300,000. Thus, the total revenue decrease under dynamic scoring averages approximately

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-\$276.1 million. This means that 0.1% of the static revenue loss is recovered. The dynamic income tax revenue impact by bracket is:

S6 - Dynamic Personal Income Tax Revenue Impact by Income Bracket

Income Bracket	Units	2019	2020	2021	2022	2023	Average
\$0 - \$4,299	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$4,300 - \$8,399	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$8,400 - \$12,599	Nominal Millions	-\$0.01	-\$0.01	-\$0.01	-\$0.01	-\$0.01	-\$0.01
\$12,600 - \$20,999	Nominal Millions	-\$0.06	-\$0.06	-\$0.06	-\$0.06	-\$0.07	-\$0.06
\$21,000 - \$35,099	Nominal Millions	-\$0.22	-\$0.22	-\$0.23	-\$0.25	-\$0.27	-\$0.24
\$35,100 - \$80,000	Nominal Millions	-\$0.69	-\$0.71	-\$0.75	-\$0.80	-\$0.86	-\$0.76
\$80,000+	Nominal Millions	-\$1.58	-\$1.61	-\$1.71	-\$1.82	-\$1.94	-\$1.73

Largely as a result of the relative decrease in population, state government expenditures **decrease** by an average of **\$3.8 million** over and above the **\$276.4 million** decrease that corresponds to the tax cut.

The results shown below are differences from the baseline REMI forecast.

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Proposals Under Consideration: Income Tax Proposal – Option A

S6 - Direct Personal Income Tax Decrease with Direct State Expenditure Decrease							
Results	Units	2019	2020	2021	2022	2023	Average
Population	Individuals	-31	-57	-101	-172	-257	-124
Total Employment	Individuals	-2,570	-2,332	-2,246	-2,209	-2,195	-2,310
Government Employment	Individuals	-2,090	-2,037	-1,988	-1,932	-1,882	-1,986
Private Non-Farm Employment	Individuals	-480	-294	-257	-277	-314	-324
Gross State Product (Value-Added)	Nominal Millions	-\$165.7	-\$152.9	-\$151.1	-\$153.7	-\$157.8	-\$156.2
Output (Industry Sales)	Nominal Millions	-\$283.8	-\$260.4	-\$255.3	-\$257.5	-\$262.3	-\$263.9
Disposable Personal Income	Nominal Millions	\$173.1	\$170.6	\$164.4	\$156.9	\$149.0	\$162.8
Government Revenue	Nominal Millions	-\$275.7	-\$275.7	-\$275.9	-\$276.3	-\$276.7	-\$276.1
Government Expenditure	Nominal Millions	-\$278.0	-\$279.3	-\$280.3	-\$281.3	-\$282.2	-\$280.2
<u>NET REVENUE</u> (Gov Rev, less Gov Exp)	Nominal Millions	\$2.3	\$3.6	\$4.4	\$5.0	\$5.5	\$4.2

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Proposals Under Consideration: Income Tax Proposal – Option A

Conclusion:

Option A would cut the number of individual income tax tables from three (3) to one (1) and lower the top marginal rate for individuals from six and nine-tenths percent (6.9%) to six and five-tenths percent (6.5%). This impact statement provides a range of possible effects on the state economy and budget that would result from adopting the proposal. By factoring in the total economic effects, dynamic scoring can indicate where the state may recover revenue reduced by cuts in tax rates.

As described above, the scenarios reflect three different approaches – one focused on production costs, another on income, and a third one that blends production and income based on publicly available data.

The blended approach shows annual economic output growing on average over 5 years by \$321.9 million and an average annual increase of 2,528 jobs, with more than 90 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$268.6 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would be mostly concentrated in the public sector.

The production-cost approach reflects the potential for tax cuts to cause a reduction in costs for businesses, which in turn affect the economy in ways that an income-only approach may not capture. Since Option A would affect after-tax wages and salaries, the plan would change the competitive position of Arkansas-based employers seeking to attract workers. Employers in the state have to compensate for the tax burden in order to compete with employers based in lower-tax states.

The production-cost approach shows annual economic output growing on average over 5 years by \$421.4 million and an average annual increase of 3,267 jobs, with more than 92 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$271.5 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would be concentrated in the public sector while the private sector would gain jobs.

The income-focused approach shows annual economic output growing on average over 5 years by \$310.7 million and an average annual increase of 2,446 jobs, with 90 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$268.3 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would be mostly concentrated in the public sector.

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Proposals Under Consideration: Income Tax Proposal – Option B

Executive Summary:

Three proposals under consideration amend and simplify the Arkansas individual income tax rates and brackets under Arkansas Code § 26-51-201, effective for tax years beginning January 1, 2019. This impact statement focuses on the proposal titled "Option B".

Option B reduces the number of individual income tax tables from three (3) to one (1) and reduces the top marginal rate for individuals from six and nine-tenths percent (6.9%) to six and five-tenths percent (6.5%). The individual income tax table under Option B is as follows:

Option B	
Individual Income Tax Bracket	Tax Rate
\$0-\$4,299	0.9%
\$4,300-\$8,399	2.4%
\$8,400-\$12,599	3.4%
\$12,600-\$20,999	4.4%
\$21,000-\$35,099	5.0%
\$35,100-\$80,000	6.0%
\$80,000+	6.5%

Option B is being analyzed in combination with an \$80 million refundable Earned Income Tax Credit (EITC), which provides relief to households in lower income tax brackets who see a statutory increase in their tax rates.

Overall, the combination of Option B and the EITC reduces Arkansas state income tax revenue by \$205,766,677, based on a state impact analysis. The static estimate does not include the total macroeconomic effects of how consumers and business respond to the policy change.

This impact statement includes fiscal, economic, and demographic estimates based on three different analytical approaches to evaluating the combination of Option B and the EITC: (1) assessing changes in business production costs; (2) assessing changes to disposable personal income; and (3) a blended approach taking both production costs and disposable personal income into consideration.

For each approach, two scenarios are simulated using a dynamic economic model – one based on tax cuts alone, and the other factoring in corresponding cuts to government spending given the sizable static decrease in revenue. A dynamic model captures the macroeconomic feedback from behavioral changes among consumers and businesses and allows this to have feedback effects on state revenues and expenditures.

The production-based approach accounts for the connection between tax cuts and the lower cost of doing business in the state. Specifically, reduced taxes translate into higher after-tax salaries, which allows employers to compete for workers without having to pay more in salaries.

Major Arkansas-based companies must now compete for workers with companies in states with lower or no income taxes. To compensate for higher taxes, employers have to offer higher salaries, which increases production costs. A tax cut, on the other hand, could attract in-migration due to the higher after-tax compensation while lowering costs for employers.

Not all employers can choose to locate in a state based on taxation. While some major employers sell their goods and services across the country and internationally, other businesses (auto mechanics, restaurants, etc.) locate based on proximity to customers. The macroeconomic analysis within this dynamic fiscal note accounts for economic migration due to changes in business conditions and anticipated after-tax disposable

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Proposals Under Consideration: Income Tax Proposal – Option B

personal income.

The blended approach shows annual economic output growing on average over 5 years by \$239.6 million and an average annual increase of 1,882 jobs, with more than 90 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$200.4 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would be mostly concentrated in the public sector.

The production-cost approach shows annual economic output growing on average over 5 years by \$313.5 million and an average annual increase of 2,430 jobs, with more than 92 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$202.6 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would be concentrated in the public sector while the private sector would gain jobs.

The income-focused approach shows annual economic output growing on average over 5 years by \$231.3 million and an average annual increase of 1,820 jobs, with over 90 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$200.2 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would be mostly concentrated in the public sector.

Methodology:

The economic and fiscal analysis of the proposals is conducted by Regional Economic Models, Inc. (REMI) using their Tax-PI v2.1 software, which is a dynamic regional macroeconomic, demographic, and fiscal model. Specifically, they use a 1-region custom model of Arkansas that is calibrated to revenues and expenditures from the FY 2017 Arkansas state budget.

Each budget category is assigned both an "economic driver" that allows it to respond to changes in a specific economic variable (e.g., Personal Income for Personal Income Tax Revenue) and a "policy variable" that allows it to directly impact a specific economic variable (e.g., Production Cost for Personal Income Tax Revenue).

The relatively large decrease in personal income taxes and recent changes in federal income tax law merit a sensitivity analysis consisting of six scenarios.

Scenarios Reflecting Range of Outcomes from REMI Tax-PI Dynamic Fiscal Analysis

- 1) Both direct personal income tax and business cost decreases with no reduction in general state government expenditures
- 2) Both direct personal income tax and business cost decreases with equal reduction in general state government expenditures
- 3) Business cost decrease with no direct reduction in general state government expenditures
- 4) Business cost decrease with equal direct reduction in general state government expenditures
- 5) Direct personal income tax decrease with no direct reduction in general state government expenditures
- 6) Direct personal income tax decrease with equal direct reduction in general state government expenditures

Scenarios 1 and 2 reflect the impacts of reductions in personal income taxes on both employees and business owners across the state of Arkansas, a blended approach based on publicly available data. Specifically,

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Proposals Under Consideration: Income Tax Proposal – Option B

Scenarios 1 and 2 assume that approximately 90% of the personal income tax reductions directly benefit employees or non-business owners and approximately 10% reduces costs of doing business.¹ Scenarios 3 and 4 reflect 100% of the personal income taxes being passed on to business owners through lower costs of doing business. Scenarios 5 and 6 reflect 100% of the personal income tax reductions being enjoyed by employees and non-business owners. The even numbered scenarios (2, 4, and 6) include an equal reduction in direct government expenditures.

For each proposal, the static income tax revenue impact and the resulting direct economic shock are input into the model for each year during the 5-year period 2019-2023. Then, the model produces estimates for each proposal of economic impacts on the state of Arkansas such as employment, GDP, output, and disposable personal income, demographic impacts on the state such as changes in population, and fiscal impacts on the state budget including both revenues and expenditures.

The results for the combination of Option B and the EITC are reported in the next section with accompanying discussion.

Economic & Fiscal Impacts:

The economic and fiscal impacts of the combination of Option B and the EITC are evaluated using six different scenarios.

Scenario 1

The first scenario follows the blended approach, accounting for both a direct personal income tax decrease and lower business costs, where the mix between the two is based on a ratio of state earnings by source.

The annual increase in Arkansas' population rises from 1,222 in 2019 to 3,888 in 2023, with a 5-year average annual increase of 2,755. This is largely driven by higher after-tax compensation rates and employment opportunities, both of which raise the level of economic in-migration.

Total employment rises by an average of 1,882, of which 90.3% comes from private non-farm sectors and 9.7% comes from the government sector. Additionally, Gross State Product (GSP) and total output (which accounts for both GSP as well as the value of intermediate inputs) increase by an average of \$144.7 million and \$239.6 million, respectively. This increase in economic activity is driven mainly by three key factors: (1) the influx of new population; (2) the increase in disposable personal income generated by lower personal income taxes; and (3) the decrease in business costs which makes Arkansas industries more competitive with imports. Disposable personal income increases by an average of \$301.7 million.

The static impact of the tax cut is a \$205.8 million loss in state revenue per year, but the increase in economic activity partially offsets the loss. Thus, the total revenue loss averages \$194.9 million. This means that 5.3% of the static revenue loss is recovered. The dynamic income tax revenue impact by bracket is:

¹ Personal income tax filings data are confidential and the responses within the Arkansas economy may not directly represent historic filing income distribution weights by personal income category or business ownership type.

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Proposals Under Consideration: Income Tax Proposal – Option B

S1 - Dynamic Personal Income Tax Revenue Impact by Income Bracket

Income Bracket	Units	2019	2020	2021	2022	2023	Average
\$0 - \$4,299	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$4,300 - \$8,399	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$8,400 - \$12,599	Nominal Millions	\$0.00	\$0.01	\$0.01	\$0.01	\$0.01	\$0.01
\$12,600 - \$20,999	Nominal Millions	\$0.04	\$0.06	\$0.07	\$0.07	\$0.07	\$0.06
\$21,000 - \$35,099	Nominal Millions	\$0.16	\$0.22	\$0.26	\$0.27	\$0.28	\$0.24
\$35,100 - \$80,000	Nominal Millions	\$0.52	\$0.71	\$0.82	\$0.88	\$0.90	\$0.77
\$80,000+	Nominal Millions	\$1.19	\$1.60	\$1.86	\$2.00	\$2.04	\$1.74

Largely as a result of the increase in population and GDP, state government expenditures **rise** by an average of **\$5.6 million**.

The results shown below are differences from the baseline REMI forecast.

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S1 - Direct Personal Income Tax Decrease & Private Non-Farm Production Cost Decrease							
Results	Units	2019	2020	2021	2022	2023	Average
Population	Individuals	1,222	2,195	2,958	3,511	3,888	2,755
Total Employment	Individuals	1,637	1,939	2,024	1,963	1,846	1,882
Government Employment	Individuals	100	163	201	219	226	182
Private Non-Farm Employment	Individuals	1,538	1,776	1,823	1,743	1,620	1,700
Gross State Product (Value-Added)	Nominal Millions	\$117.3	\$143.4	\$154.8	\$156.0	\$152.1	\$144.7
Output (Industry Sales)	Nominal Millions	\$195.1	\$238.3	\$256.5	\$257.6	\$250.3	\$239.6
Disposable Personal Income	Nominal Millions	\$264.1	\$292.1	\$309.9	\$319.6	\$323.0	\$301.7
Government Revenue	Nominal Millions	-\$197.1	-\$195.5	-\$194.4	-\$193.8	-\$193.5	-\$194.9
Government Expenditure	Nominal Millions	\$2.3	\$4.3	\$5.9	\$7.1	\$8.0	\$5.6
NET REVENUE (Gov Rev, less Gov Exp)	Nominal Millions	-\$199.5	-\$199.8	-\$200.3	-\$201.0	-\$201.5	-\$200.4

Scenario 2

The second scenario also follows the blended approach, accounting for both a direct personal income tax decrease and lower business costs, where the mix between the two is based on a ratio of state earnings by source. In addition, this scenario accounts for a cut in general state government expenditures equal to the size of the personal income tax cut.

The annual **decrease** in Arkansas' population rises from **66** in 2019 to **209** in 2023, with a 5-year average annual **decrease** of **135**. This is largely driven by lower employment opportunities, which lowers the level of economic in-migration.

Total employment **falls** by an average of **1,659**, of which **10.9%** comes from private non-farm sectors and **89.1%** comes from the government sector. Additionally, Gross State Product (GSP) and total output (which accounts for both GSP as well as the value of intermediate inputs) **decrease** by an average of **\$112.3 million** and **\$188.2 million**, respectively. This decrease in economic activity is driven mainly by two key factors: (1) the decrease in population; and (2) the decrease in government expenditures. Disposable personal income **increases** by an average of **\$102.0 million**.

The static impact of the tax cut is a **\$205.8 million loss** in state revenue per year, and the decrease in economic activity generates an additional loss. Thus, the total revenue **loss averages \$206.2 million**. This means that the static revenue loss is **increased** by another **0.2%**. The dynamic income tax revenue impact by

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bracket is:

S2 - Dynamic Personal Income Tax Revenue Impact by Income Bracket

Income Bracket	Units	2019	2020	2021	2022	2023	Average
\$0 - \$4,299	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$4,300 - \$8,399	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$8,400 - \$12,599	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$12,600 - \$20,999	Nominal Millions	-\$0.04	-\$0.04	-\$0.05	-\$0.05	-\$0.05	-\$0.05
\$21,000 - \$35,099	Nominal Millions	-\$0.16	-\$0.16	-\$0.17	-\$0.18	-\$0.19	-\$0.17
\$35,100 - \$80,000	Nominal Millions	-\$0.53	-\$0.53	-\$0.55	-\$0.58	-\$0.60	-\$0.56
\$80,000+	Nominal Millions	-\$1.19	-\$1.20	-\$1.25	-\$1.31	-\$1.37	-\$1.27

Largely as a result of the decrease in population and GDP, state government expenditures **decrease** by an average of **\$2.8 million** over and above the **\$205.8 million decrease** in expenditures corresponding with the tax cut for a total **decrease** of **\$208.6 million**. Thus, the average annual change in net revenue is an **increase** of **\$2.4 million**.

The results shown below are differences from the baseline REMI forecast.

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S2 - Direct Personal Income Tax Decrease & Private Non-Farm Production Cost Decrease with Direct State Expenditure Decrease

Results	Units	2019	2020	2021	2022	2023	Average
Population	Individuals	-66	-102	-132	-168	-209	-135
Total Employment	Individuals	-1,922	-1,707	-1,607	-1,547	-1,511	-1,659
Government Employment	Individuals	-1,558	-1,519	-1,481	-1,437	-1,397	-1,478
Private Non-Farm Employment	Individuals	-363	-188	-126	-110	-114	-180
Gross State Product (Value-Added)	Nominal Millions	-\$124.8	-\$112.7	-\$108.4	-\$107.6	-\$108.2	-\$112.3
Output (Industry Sales)	Nominal Millions	-\$212.9	-\$190.5	-\$181.5	-\$178.3	-\$177.6	-\$188.2
Disposable Personal Income	Nominal Millions	\$106.7	\$106.1	\$103.0	\$99.2	\$95.1	\$102.0
Government Revenue	Nominal Millions	-\$206.1	-\$206.0	-\$206.2	-\$206.4	-\$206.5	-\$206.2
Government Expenditure	Nominal Millions	-\$207.0	-\$208.0	-\$208.7	-\$209.4	-\$210.0	-\$208.6
NET REVENUE (Gov Rev, less Gov Exp)	Nominal Millions	\$0.9	\$1.9	\$2.6	\$3.0	\$3.4	\$2.4

Scenario 3

The third scenario treats 100% of the personal income tax cut as a decrease in business costs.

The annual **increase** in Arkansas' population rises from **831** in 2019 to **3,736** in 2023, with a 5-year average annual **increase** of **2,367**. This is largely driven by higher employment opportunities, which raises the level of economic in-migration.

Total employment **rises** by an average of **2,430**, of which **92.6%** comes from private non-farm sectors and **7.4%** comes from the government sector. Additionally, Gross State Product (GSP) and total output (which accounts for both GSP as well as the value of intermediate inputs) increase by an average of **\$180.2 million** and **\$313.5 million**, respectively. This **increase** in economic activity is driven mainly by two key factors: (1) the influx of new population; and (2) the decrease in business costs which makes Arkansas industries more competitive with imports. Disposable personal income **increases** by an average of **\$130.7 million**.

The static impact of the tax cut is a **\$205.8 million loss** in state revenue per year, but the increase in economic activity partially offsets the loss. Thus, the total revenue **loss** averages **\$197.3 million**. This means that **4.1%** of the static revenue loss is recovered. The dynamic income tax revenue impact by bracket is:

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S3 - Dynamic Personal Income Tax Revenue Impact by Income Bracket

Income Bracket	Units	2019	2020	2021	2022	2023	Average
\$0 - \$4,299	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$4,300 - \$8,399	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$8,400 - \$12,599	Nominal Millions	\$0.00	\$0.01	\$0.01	\$0.01	\$0.01	\$0.01
\$12,600 - \$20,999	Nominal Millions	\$0.04	\$0.06	\$0.07	\$0.09	\$0.10	\$0.07
\$21,000 - \$35,099	Nominal Millions	\$0.14	\$0.22	\$0.28	\$0.33	\$0.37	\$0.27
\$35,100 - \$80,000	Nominal Millions	\$0.44	\$0.69	\$0.90	\$1.07	\$1.20	\$0.86
\$80,000+	Nominal Millions	\$1.00	\$1.58	\$2.05	\$2.44	\$2.72	\$1.96

Largely as a result of the increase in population, state government expenditures rise by an average of **\$5.3 million**.

The results shown below are differences from the baseline REMI forecast.

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S3 - Direct Private Non-Farm Production Cost Decrease							
Results	Units	2019	2020	2021	2022	2023	Average
Population	Individuals	831	1,664	2,453	3,151	3,736	2,367
Total Employment	Individuals	1,559	2,194	2,607	2,837	2,952	2,430
Government Employment	Individuals	76	141	193	231	259	180
Private Non-Farm Employment	Individuals	1,483	2,053	2,414	2,606	2,693	2,250
Gross State Product (Value-Added)	Nominal Millions	\$104.3	\$154.1	\$190.9	\$217.0	\$234.8	\$180.2
Output (Industry Sales)	Nominal Millions	\$180.6	\$268.3	\$332.5	\$377.6	\$408.4	\$313.5
Disposable Personal Income	Nominal Millions	\$66.3	\$104.9	\$137.0	\$162.9	\$182.4	\$130.7
Government Revenue	Nominal Millions	-\$201.1	-\$198.8	-\$196.9	-\$195.4	-\$194.2	-\$197.3
Government Expenditure	Nominal Millions	\$1.7	\$3.6	\$5.4	\$7.1	\$8.7	\$5.3
NET REVENUE (Gov Rev, less Gov Exp)	Nominal Millions	-\$202.8	-\$202.4	-\$202.3	-\$202.5	-\$202.8	-\$202.6

Scenario 4

The fourth scenario also treats 100% of the personal income tax cut as a decrease in business costs. In addition, this scenario accounts for a cut in general state government expenditures equal to the size of the personal income tax cut.

The annual **decrease** in Arkansas' population falls from **459** in 2019 to **365** in 2023, with a 5-year average annual **decrease** of **526**. This is largely driven by lower employment opportunities, which lowers the level of economic in-migration.

Employment in the private non-farm sectors **increases** annually over the next 5 years by an average of **367** jobs while government sector employment **declines** by an average of **1,480** jobs, creating an average total employment **decline** of **1,113** jobs. Additionally, Gross State Product (GSP) and Total Output (which accounts for both GSP as well as the value of intermediate inputs) decline by an average of **\$77.0 million** and **\$114.6 million**, respectively. This decline in economic activity is driven mainly by two key factors: (1) the decline in population; and (2) a decrease in disposable personal income caused by a decline in government employment. Disposable personal income **decreases** by an average of **\$69.2 million**.

The static impact of the tax cut is a **\$205.8 million loss** in state revenue per year, and the decrease in economic activity generates an additional loss. Thus, the total revenue loss averages **\$208.7 million**. This

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means that the static revenue loss is **increased** by another 1.4%. The dynamic income tax revenue impact by bracket is:

S4 - Dynamic Personal Income Tax Revenue Impact by Income Bracket

Income Bracket	Units	2019	2020	2021	2022	2023	Average
\$0 - \$4,299	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$4,300 - \$8,399	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$8,400 - \$12,599	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$12,600 - \$20,999	Nominal Millions	-\$0.05	-\$0.04	-\$0.04	-\$0.03	-\$0.03	-\$0.04
\$21,000 - \$35,099	Nominal Millions	-\$0.19	-\$0.17	-\$0.15	-\$0.12	-\$0.09	-\$0.14
\$35,100 - \$80,000	Nominal Millions	-\$0.61	-\$0.54	-\$0.47	-\$0.38	-\$0.30	-\$0.46
\$80,000+	Nominal Millions	-\$1.38	-\$1.23	-\$1.06	-\$0.87	-\$0.69	-\$1.05

Largely as a result of the decrease in population and GDP, state government expenditures **decrease** by an average of \$3.1 million over and above the **\$205.8 million decrease** in expenditures corresponding with the tax cut for a total decrease of **\$208.9 million**. Thus, the average annual change in net revenue is an increase of approximately **\$200,000**.

The results shown below are differences from the baseline REMI forecast.

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S4 - Direct Private Non-Farm Production Cost Decrease with Direct State Expenditure Decrease							
Results	Units	2019	2020	2021	2022	2023	Average
Population	Individuals	-459	-634	-639	-532	-365	-526
Total Employment	Individuals	-2,002	-1,454	-1,026	-675	-408	-1,113
Government Employment	Individuals	-1,582	-1,541	-1,489	-1,424	-1,364	-1,480
Private Non-Farm Employment	Individuals	-420	87	463	750	957	367
Gross State Product (Value-Added)	Nominal Millions	-\$137.9	-\$102.1	-\$72.5	-\$46.8	-\$25.7	-\$77.0
Output (Industry Sales)	Nominal Millions	-\$227.6	-\$160.9	-\$105.9	-\$58.6	-\$19.9	-\$114.6
Disposable Personal Income	Nominal Millions	-\$91.2	-\$81.3	-\$70.1	-\$57.6	-\$45.7	-\$69.2
Government Revenue	Nominal Millions	-\$210.1	-\$209.4	-\$208.7	-\$207.9	-\$207.2	-\$208.7
Government Expenditure	Nominal Millions	-\$207.6	-\$208.7	-\$209.2	-\$209.4	-\$209.4	-\$208.9
<u>NET REVENUE</u> (Gov Rev, less Gov Exp)	Nominal Millions	-\$2.5	-\$0.7	\$0.6	\$1.5	\$2.1	\$0.2

Scenario 5

The fifth scenario treats 100% of the personal income tax cut as a direct decrease in personal income taxes.

The annual **increase** in Arkansas' population rises from 1,266 in 2019 to 3,905 in 2023, with a 5-year average annual **increase** of 2,798. This is largely driven by higher after-tax compensation rates raising the level of economic in-migration.

Total employment **rises** by an average of 1,820, of which 90.1% comes from private non-farm sectors and 9.9% comes from the government sector. Additionally, Gross State Product (GSP) and total output (which accounts for both GSP as well as the value of intermediate inputs) increase by an average of \$140.7 million and \$231.3 million, respectively. This increase in economic activity is driven mainly by two key factors: (1) the influx of new population; and (2) the increase in disposable personal income generated by lower personal income taxes. Specifically, disposable personal income **increases** by an average of \$320.9 million.

The static impact of the tax cut is a \$205.8 million **loss** in state revenue per year, but the increase in economic activity partially offsets the loss. Thus, the total revenue **loss** averages \$194.6 million. This means that 5.4% of the static revenue loss is recovered. The dynamic income tax revenue impact by bracket is:

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S5 - Dynamic Personal Income Tax Revenue Impact by Income Bracket

Income Bracket	Units	2019	2020	2021	2022	2023	Average
\$0 - \$4,299	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$4,300 - \$8,399	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$8,400 - \$12,599	Nominal Millions	\$0.00	\$0.01	\$0.01	\$0.01	\$0.01	\$0.01
\$12,600 - \$20,999	Nominal Millions	\$0.04	\$0.06	\$0.07	\$0.07	\$0.07	\$0.06
\$21,000 - \$35,099	Nominal Millions	\$0.17	\$0.22	\$0.25	\$0.27	\$0.27	\$0.24
\$35,100 - \$80,000	Nominal Millions	\$0.53	\$0.71	\$0.81	\$0.86	\$0.87	\$0.75
\$80,000+	Nominal Millions	\$1.21	\$1.60	\$1.84	\$1.95	\$1.97	\$1.71

Largely as a result of the increase in population and GDP, state government expenditures rise by an average of \$5.6 million.

The results shown below are differences from the baseline REMI forecast.

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S5 - Direct Personal Income Tax Decrease							
Results	Units	2019	2020	2021	2022	2023	Average
Population	Individuals	1,266	2,254	3,014	3,552	3,905	2,798
Total Employment	Individuals	1,646	1,910	1,958	1,865	1,723	1,820
Government Employment	Individuals	102	165	201	218	222	182
Private Non-Farm Employment	Individuals	1,544	1,745	1,757	1,647	1,500	1,639
Gross State Product (Value-Added)	Nominal Millions	\$118.7	\$142.2	\$150.7	\$149.2	\$142.9	\$140.7
Output (Industry Sales)	Nominal Millions	\$196.7	\$235.0	\$248.0	\$244.2	\$232.7	\$231.3
Disposable Personal Income	Nominal Millions	\$286.2	\$313.1	\$329.3	\$337.1	\$338.8	\$320.9
Government Revenue	Nominal Millions	-\$196.7	-\$195.1	-\$194.1	-\$193.6	-\$193.4	-\$194.6
Government Expenditure	Nominal Millions	\$2.4	\$4.4	\$6.0	\$7.1	\$8.0	\$5.6
<u>NET REVENUE</u> (Gov Rev, less Gov Exp)	Nominal Millions	-\$199.1	-\$199.5	-\$200.1	-\$200.8	-\$201.4	-\$200.2

Scenario 6

The sixth scenario also treats 100% of the personal income tax cut as a direct decrease in personal income taxes. In addition, this scenario accounts for a cut in general state government expenditures equal to the size of the personal income tax cut.

The annual **decline** in Arkansas' population **rises** from 23 in 2019 to 191 in 2023, with a 5-year average annual **decrease** of 92. This is largely driven by higher after-tax compensation rates raising the level of economic in-migration.

Total employment **decreases** by an average of 1,720, of which 14.1% comes from private non-farm sectors and 85.9% comes from the government sector. Additionally, Gross State Product (GSP) and total output (which accounts for both GSP as well as the value of intermediate inputs) **decrease** by an average of **\$116.3 million** and **\$196.4 million**, respectively. This **decrease** in economic activity is driven mainly by the **decrease** in in-state consumption that comes from two key factors: (1) the decrease in population; and (2) a portion of consumers' increased after-tax income being spent on out-of-state goods and services. Specifically, disposable personal income will **increase** by an average of **\$121.2 million**.

The static impact of the tax cut is a **\$205.8 million loss** in state revenue per year, and the decrease in economic activity generates an additional loss. Thus, the total revenue **loss** averages **\$206.0 million**. This means that the static revenue loss is increased by another 0.1%. The dynamic income tax revenue impact by

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bracket is:

S6 - Dynamic Personal Income Tax Revenue Impact by Income Bracket

Income Bracket	Units	2019	2020	2021	2022	2023	Average
\$0 - \$4,299	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$4,300 - \$8,399	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$8,400 - \$12,599	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$12,600 - \$20,999	Nominal Millions	-\$0.04	-\$0.04	-\$0.05	-\$0.05	-\$0.05	-\$0.05
\$21,000 - \$35,099	Nominal Millions	-\$0.16	-\$0.16	-\$0.17	-\$0.19	-\$0.20	-\$0.18
\$35,100 - \$80,000	Nominal Millions	-\$0.52	-\$0.53	-\$0.56	-\$0.60	-\$0.64	-\$0.57
\$80,000+	Nominal Millions	-\$1.17	-\$1.20	-\$1.27	-\$1.36	-\$1.45	-\$1.29

Largely as a result of the relative decrease in population, state government expenditures **decrease** by an average of **\$2.8 million** over and above the **\$205.8 million** decrease that corresponds to the tax cut.

The results shown below are differences from the baseline REMI forecast.

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S6 - Direct Personal Income Tax Decrease with Direct State Expenditure Decrease							
Results	Units	2019	2020	2021	2022	2023	Average
Population	Individuals	-23	-42	-75	-128	-191	-92
Total Employment	Individuals	-1,913	-1,736	-1,672	-1,644	-1,634	-1,720
Government Employment	Individuals	-1,556	-1,516	-1,480	-1,438	-1,401	-1,478
Private Non-Farm Employment	Individuals	-357	-219	-191	-206	-234	-242
Gross State Product (Value-Added)	Nominal Millions	-\$123.4	-\$113.8	-\$112.5	-\$114.4	-\$117.4	-\$116.3
Output (Industry Sales)	Nominal Millions	-\$211.3	-\$193.8	-\$190.0	-\$191.7	-\$195.2	-\$196.4
Disposable Personal Income	Nominal Millions	\$128.8	\$127.0	\$122.4	\$116.8	\$110.9	\$121.2
Government Revenue	Nominal Millions	-\$205.7	-\$205.7	-\$205.9	-\$206.2	-\$206.5	-\$206.0
Government Expenditure	Nominal Millions	-\$206.9	-\$207.9	-\$208.7	-\$209.4	-\$210.0	-\$208.6
<u>NET REVENUE</u> (Gov Rev, less Gov Exp)	Nominal Millions	\$1.3	\$2.2	\$2.8	\$3.2	\$3.6	\$2.6

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Conclusion:

Option B would cut the number of individual income tax tables from three (3) to one (1) and lower the top marginal rate for individuals from six and nine-tenths percent (6.9%) to six and five-tenths percent (6.5%). Also, a refundable EITC is being considered in combination with Option B. This impact statement provides a range of possible effects on the state economy and budget that would result from adopting the proposal. By factoring in the total economic effects, dynamic scoring can indicate where the state may recover revenue reduced by cuts in tax rates.

As described above, the scenarios reflect three different approaches – one focused on production costs, another on income, and a third one that blends production and income based on publicly available data.

The blended approach shows annual economic output growing on average over 5 years by \$239.6 million and an average annual increase of 1,882 jobs, with more than 90 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$200.4 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would be mostly concentrated in the public sector.

The production-cost approach reflects the potential for tax cuts to cause a reduction in costs for businesses, which in turn affect the economy in ways that an income-only approach may not capture. Since Option B and the EITC would affect after-tax wages and salaries, the plan would change the competitive position of Arkansas-based employers seeking to attract workers. Employers in the state have to compensate for the tax burden in order to compete with employers based in lower-tax states.

The production-cost approach shows annual economic output growing on average over 5 years by \$313.5 million and an average annual increase of 2,430 jobs, with more than 92 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$202.6 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would be concentrated in the public sector while the private sector would gain jobs.

The income-focused approach shows annual economic output growing on average over 5 years by \$231.3 million and an average annual increase of 1,820 jobs, with over 90 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$200.2 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would be mostly concentrated in the public sector.

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Executive Summary:

Three proposals under consideration amend and simplify the Arkansas individual income tax rates and brackets under Arkansas Code § 26-51-201, effective for tax years beginning January 1, 2019. This impact statement focuses on the Governor's Proposal.

The Governor's Proposal reduces the top marginal rate for individuals from six and nine-tenths percent (6.9%) to six percent (6%). The total static fiscal impact of the Governor's Proposal is a reduction in Arkansas state income tax revenue of \$180,000,000.

This impact statement includes fiscal, economic, and demographic estimates based on three different analytical approaches to evaluating the Governor's Proposal: (1) assessing changes in business production costs; (2) assessing changes to disposable personal income; and (3) a blended approach taking both production costs and disposable personal income into consideration.

For each approach, two scenarios are simulated using a dynamic economic model – one based on tax cuts alone, and the other factoring in corresponding cuts to government spending given the sizable static decrease in revenue. A dynamic model captures the macroeconomic feedback from behavioral changes among consumers and businesses and allows this to have feedback effects on state revenues and expenditures.

The production-based approach accounts for the connection between tax cuts and the lower cost of doing business in the state. Specifically, reduced taxes translate into higher after-tax salaries, which allows employers to compete for workers without having to pay more in salaries.

Major Arkansas-based companies must now compete for workers with companies in states with lower or no income taxes. To compensate for higher taxes, employers have to offer higher salaries, which increases production costs. A tax cut, on the other hand, could attract in-migration due to the higher after-tax compensation while lowering costs for employers.

Not all employers can choose to locate in a state based on taxation. While some major employers sell their goods and services across the country and internationally, other businesses (auto mechanics, restaurants, etc.) locate based on proximity to customers. The macroeconomic analysis within this dynamic fiscal note accounts for economic migration due to changes in business conditions and anticipated after-tax disposable personal income.

The blended approach shows annual economic output growing on average over 5 years by \$209.6 million and an average annual increase of 1,646 jobs, with more than 90 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$174.9 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would be mostly concentrated in the public sector.

The production-cost approach shows annual economic output growing on average over 5 years by \$274.0 million and an average annual increase of 2,124 jobs, with more than 92 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$176.8 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would be concentrated in the public sector while the private sector would gain jobs.

The income-focused approach shows annual economic output growing on average over 5 years by \$202.4 million and an average annual increase of 1,593 jobs, with 90 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$174.7 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would

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be mostly concentrated in the public sector.

Methodology:

The economic and fiscal analysis of the proposals is conducted by Regional Economic Models, Inc. (REMI) using their Tax-PI v2.1 software, which is a dynamic regional macroeconomic, demographic, and fiscal model. Specifically, they use a 1-region custom model of Arkansas that is calibrated to revenues and expenditures from the FY 2017 Arkansas state budget.

Each budget category is assigned both an "economic driver" that allows it to respond to changes in a specific economic variable (e.g., Personal Income for Personal Income Tax Revenue) and a "policy variable" that allows it to directly impact a specific economic variable (e.g., Production Cost for Personal Income Tax Revenue).

The relatively large decrease in personal income taxes and recent changes in federal income tax law merit a sensitivity analysis consisting of six scenarios.

Scenarios Reflecting Range of Outcomes from REMI Tax-PI Dynamic Fiscal Analysis

- 1) Both direct personal income tax and business cost decreases with no reduction in general state government expenditures
- 2) Both direct personal income tax and business cost decreases with equal reduction in general state government expenditures
- 3) Business cost decrease with no direct reduction in general state government expenditures
- 4) Business cost decrease with equal direct reduction in general state government expenditures
- 5) Direct personal income tax decrease with no direct reduction in general state government expenditures
- 6) Direct personal income tax decrease with equal direct reduction in general state government expenditures

Scenarios 1 and 2 reflect the impacts of reductions in personal income taxes on both employees and business owners across the state of Arkansas, a blended approach based on publicly available data. Specifically, Scenarios 1 and 2 assume that approximately 90% of the personal income tax reductions directly benefit employees or non-business owners and approximately 10% reduces costs of doing business.¹ Scenarios 3 and 4 reflect 100% of the personal income taxes being passed on to business owners through lower costs of doing business. Scenarios 5 and 6 reflect 100% of the personal income tax reductions being enjoyed by employees and non-business owners. The even numbered scenarios (2, 4, and 6) include an equal reduction in direct government expenditures.

For each proposal, the static income tax revenue impact and the resulting direct economic shock are input into the model for each year during the 5-year period 2019-2023. Then, the model produces estimates for each proposal of economic impacts on the state of Arkansas such as employment, GDP, output, and disposable personal income, demographic impacts on the state such as changes in population, and fiscal impacts on the state budget including both revenues and expenditures.

The results for the Governor’s Proposal are reported in the next section with accompanying discussion.

¹ Personal income tax filings data are confidential and the responses within the Arkansas economy may not directly represent historic filing income distribution weights by personal income category or business ownership type.

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Economic & Fiscal Impacts:

The economic and fiscal impacts of the governor’s proposal are evaluated using six different scenarios.

Scenario 1

The first scenario follows the blended approach, accounting for both a direct personal income tax decrease and lower business costs, where the mix between the two is based on a ratio of state earnings by source.

The annual increase in Arkansas’ population rises from 1,070 in 2019 to 3,401 in 2023, with a 5-year average annual increase of 2,410. This is largely driven by higher after-tax compensation rates and employment opportunities, both of which raise the level of economic in-migration.

Total employment rises by an average of 1,646, of which 90.3% comes from private non-farm sectors and 9.7% comes from the government sector. Additionally, Gross State Product (GSP) and total output (which accounts for both GSP as well as the value of intermediate inputs) increase by an average of \$126.6 million and \$209.6 million, respectively. This increase in economic activity is driven mainly by three key factors: (1) the influx of new population; (2) the increase in disposable personal income generated by lower personal income taxes; and (3) the decrease in business costs which makes Arkansas industries more competitive with imports. Disposable personal income increases by an average of \$264.0 million.

The static impact of the tax cut is a \$180.0 million loss in state revenue per year, but the increase in economic activity partially offsets the loss. Thus, the total revenue loss averages \$170.0 million. This means that 5.6% of the static revenue loss is recovered. The dynamic income tax revenue impact by bracket is:

S1 - Dynamic Personal Income Tax Revenue Impact by Income Bracket

Income Bracket	Units	2019	2020	2021	2022	2023	Average
\$0 - \$4,299	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$4,300 - \$8,399	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$8,400 - \$12,599	Nominal Millions	\$0.00	\$0.01	\$0.01	\$0.01	\$0.01	\$0.01
\$12,600 - \$20,999	Nominal Millions	\$0.04	\$0.05	\$0.06	\$0.06	\$0.06	\$0.05
\$21,000 - \$35,099	Nominal Millions	\$0.14	\$0.19	\$0.22	\$0.24	\$0.25	\$0.21
\$35,100 - \$80,000	Nominal Millions	\$0.46	\$0.62	\$0.72	\$0.77	\$0.79	\$0.67
\$80,000+	Nominal Millions	\$1.04	\$1.40	\$1.63	\$1.75	\$1.79	\$1.52

Largely as a result of the increase in population and GDP, state government expenditures rise by an average of \$4.9 million.

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The results shown below are differences from the baseline REMI forecast.

S1 - Direct Personal Income Tax Decrease & Private Non-Farm Production Cost Decrease							
Results	Units	2019	2020	2021	2022	2023	Average
Population	Individuals	1,070	1,920	2,587	3,072	3,401	2,410
Total Employment	Individuals	1,432	1,696	1,770	1,717	1,615	1,646
Government Employment	Individuals	87	142	175	192	198	159
Private Non-Farm Employment	Individuals	1,345	1,554	1,595	1,525	1,417	1,487
Gross State Product (Value-Added)	Nominal Millions	\$102.6	\$125.4	\$135.4	\$136.5	\$133.1	\$126.6
Output (Industry Sales)	Nominal Millions	\$170.7	\$208.5	\$224.4	\$225.3	\$219.0	\$209.6
Disposable Personal Income	Nominal Millions	\$231.0	\$255.6	\$271.1	\$279.6	\$282.6	\$264.0
Government Revenue	Nominal Millions	-\$172.0	-\$170.6	-\$169.6	-\$169.1	-\$168.8	-\$170.0
Government Expenditure	Nominal Millions	\$2.0	\$3.8	\$5.2	\$6.3	\$7.0	\$4.9
NET REVENUE (Gov Rev, less Gov Exp)	Nominal Millions	-\$174.1	-\$174.4	-\$174.8	-\$175.4	-\$175.9	-\$174.9

Scenario 2

The second scenario also follows the blended approach, accounting for both a direct personal income tax decrease and lower business costs, where the mix between the two is based on a ratio of state earnings by source. In addition, this scenario accounts for a cut in general state government expenditures equal to the size of the personal income tax cut.

The annual **decrease** in Arkansas' population rises from **58** in 2019 to **182** in 2023, with a 5-year average annual **decrease** of **118**. This is largely driven by lower employment opportunities, which lowers the level of economic in-migration.

Total employment **falls** by an average of **1,451**, of which **10.9%** comes from private non-farm sectors and **89.1%** comes from the government sector. Additionally, Gross State Product (GSP) and total output (which accounts for both GSP as well as the value of intermediate inputs) **decrease** by an average of **\$98.3 million** and **\$164.6 million**, respectively. This decrease in economic activity is driven mainly by two key factors: (1) the decrease in population; and (2) the decrease in government expenditures. Disposable personal income **increases** by an average of **\$89.2 million**.

The static impact of the tax cut is a **\$180.0 million loss** in state revenue per year, and the change in economic

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activity does not materially affect the size of this loss. Thus, the total revenue loss averages **\$180.0 million**. This means that **0.0%** of the static revenue loss is recovered. The dynamic income tax revenue impact by bracket is:

S2 - Dynamic Personal Income Tax Revenue Impact by Income Bracket

Income Bracket	Units	2019	2020	2021	2022	2023	Average
\$0 - \$4,299	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$4,300 - \$8,399	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$8,400 - \$12,599	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$12,600 - \$20,999	Nominal Millions	-\$0.04	-\$0.04	-\$0.04	-\$0.04	-\$0.04	-\$0.04
\$21,000 - \$35,099	Nominal Millions	-\$0.14	-\$0.14	-\$0.15	-\$0.16	-\$0.16	-\$0.15
\$35,100 - \$80,000	Nominal Millions	-\$0.46	-\$0.46	-\$0.48	-\$0.50	-\$0.53	-\$0.49
\$80,000+	Nominal Millions	-\$1.04	-\$1.05	-\$1.09	-\$1.14	-\$1.20	-\$1.11

Largely as a result of the decrease in population and GDP, state government expenditures **decrease** by an average of **\$2.5 million** over and above the **\$180.0 million decrease** in expenditures corresponding with the tax cut for a total **decrease** of **\$182.5 million**. Thus, the average annual change in net revenue is an **increase** of **\$2.5 million**.

The results shown below are differences from the baseline REMI forecast.

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S2 - Direct Personal Income Tax Decrease & Private Non-Farm Production Cost Decrease with Direct State Expenditure Decrease

Results	Units	2019	2020	2021	2022	2023	Average
Population	Individuals	-58	-89	-115	-147	-182	-118
Total Employment	Individuals	-1,681	-1,494	-1,405	-1,353	-1,322	-1,451
Government Employment	Individuals	-1,363	-1,329	-1,295	-1,257	-1,222	-1,293
Private Non-Farm Employment	Individuals	-318	-165	-110	-96	-100	-158
Gross State Product (Value-Added)	Nominal Millions	-\$109.2	-\$98.5	-\$94.9	-\$94.1	-\$94.7	-\$98.3
Output (Industry Sales)	Nominal Millions	-\$186.3	-\$166.7	-\$158.8	-\$156.0	-\$155.4	-\$164.6
Disposable Personal Income	Nominal Millions	\$93.3	\$92.8	\$90.1	\$86.8	\$83.2	\$89.2
Government Revenue	Nominal Millions	-\$179.9	-\$179.8	-\$179.9	-\$180.1	-\$180.3	-\$180.0
Government Expenditure	Nominal Millions	-\$181.1	-\$181.9	-\$182.6	-\$183.2	-\$183.7	-\$182.5
NET REVENUE (Gov Rev, less Gov Exp)	Nominal Millions	\$1.2	\$2.1	\$2.7	\$3.1	\$3.4	\$2.5

Scenario 3

The third scenario treats 100% of the personal income tax cut as a decrease in business costs.

The annual **increase** in Arkansas' population rises from **727** in 2019 to **3,266** in 2023, with a 5-year average annual **increase** of **2,070**. This is largely driven by higher employment opportunities, which raises the level of economic in-migration.

Total employment **rises** by an average of **2,124**, of which **92.6%** comes from private non-farm sectors and **7.4%** comes from the government sector. Additionally, Gross State Product (GSP) and total output (which accounts for both GSP as well as the value of intermediate inputs) increase by an average of **\$157.5 million** and **\$274.0 million**, respectively. This **increase** in economic activity is driven mainly by two key factors: (1) the influx of new population; and (2) the decrease in business costs which makes Arkansas industries more competitive with imports. Disposable personal income **increases** by an average of **\$114.3 million**.

The static impact of the tax cut is a **\$180.0 million loss** in state revenue per year, but the increase in economic activity partially offsets the loss. Thus, the total revenue **loss** averages **\$172.2 million**. This means that **4.4%** of the static revenue loss is recovered. The dynamic income tax revenue impact by bracket is:

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S3 - Dynamic Personal Income Tax Revenue Impact by Income Bracket

Income Bracket	Units	2019	2020	2021	2022	2023	Average
\$0 - \$4,299	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$4,300 - \$8,399	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$8,400 - \$12,599	Nominal Millions	\$0.00	\$0.01	\$0.01	\$0.01	\$0.01	\$0.01
\$12,600 - \$20,999	Nominal Millions	\$0.03	\$0.05	\$0.06	\$0.08	\$0.09	\$0.06
\$21,000 - \$35,099	Nominal Millions	\$0.12	\$0.19	\$0.25	\$0.29	\$0.33	\$0.23
\$35,100 - \$80,000	Nominal Millions	\$0.39	\$0.61	\$0.79	\$0.94	\$1.05	\$0.75
\$80,000+	Nominal Millions	\$0.87	\$1.38	\$1.80	\$2.13	\$2.38	\$1.71

Largely as a result of the increase in population, state government expenditures rise by an average of \$4.6 million.

The results shown below are differences from the baseline REMI forecast.

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S3 - Direct Private Non-Farm Production Cost Decrease

Results	Units	2019	2020	2021	2022	2023	Average
Population	Individuals	727	1,456	2,145	2,755	3,266	2,070
Total Employment	Individuals	1,364	1,919	2,279	2,480	2,580	2,124
Government Employment	Individuals	66	123	169	202	226	157
Private Non-Farm Employment	Individuals	1,298	1,796	2,111	2,278	2,353	1,967
Gross State Product (Value-Added)	Nominal Millions	\$91.2	\$134.8	\$166.9	\$189.6	\$205.1	\$157.5
Output (Industry Sales)	Nominal Millions	\$158.0	\$234.6	\$290.7	\$330.0	\$356.8	\$274.0
Disposable Personal Income	Nominal Millions	\$58.0	\$91.8	\$119.8	\$142.4	\$159.4	\$114.3
Government Revenue	Nominal Millions	-\$175.5	-\$173.5	-\$171.8	-\$170.5	-\$169.4	-\$172.2
Government Expenditure	Nominal Millions	\$1.5	\$3.1	\$4.7	\$6.2	\$7.6	\$4.6
NET REVENUE (Gov Rev, less Gov Exp)	Nominal Millions	-\$177.0	-\$176.6	-\$176.6	-\$176.7	-\$177.0	-\$176.8

Scenario 4

The fourth scenario also treats 100% of the personal income tax cut as a decrease in business costs. In addition, this scenario accounts for a cut in general state government expenditures equal to the size of the personal income tax cut.

The annual **decrease** in Arkansas’ population falls from **402** in 2019 to **321** in 2023, with a 5-year average annual **decrease** of **461**. This is largely driven by lower employment opportunities, which lowers the level of economic in-migration.

Employment in the private non-farm sectors **increases** annually over the next 5 years by an average of **320** jobs while government sector employment **declines** by an average of **1,295** jobs, creating an average total employment **decline** of **975** jobs. Additionally, Gross State Product (GSP) and Total Output (which accounts for both GSP as well as the value of intermediate inputs) decline by an average of **\$67.5 million** and **\$100.4 million**, respectively. This decline in economic activity is driven mainly by two key factors: (1) the decline in population; and (2) a decrease in disposable personal income caused by a decline in government employment. Disposable personal income **decreases** by an average of **\$60.6 million**.

The static impact of the tax cut is a **\$180.0 million loss** in state revenue per year, and the decrease in economic activity generates an additional loss. Thus, the total revenue loss averages **\$182.1 million**. This means that the static revenue loss is **increased** by another **1.2%**. The dynamic income tax revenue impact by

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bracket is:

S4 - Dynamic Personal Income Tax Revenue Impact by Income Bracket

Income Bracket	Units	2019	2020	2021	2022	2023	Average
\$0 - \$4,299	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$4,300 - \$8,399	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$8,400 - \$12,599	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$12,600 - \$20,999	Nominal Millions	-\$0.04	-\$0.04	-\$0.03	-\$0.03	-\$0.02	-\$0.03
\$21,000 - \$35,099	Nominal Millions	-\$0.17	-\$0.15	-\$0.13	-\$0.10	-\$0.08	-\$0.13
\$35,100 - \$80,000	Nominal Millions	-\$0.53	-\$0.47	-\$0.41	-\$0.34	-\$0.27	-\$0.40
\$80,000+	Nominal Millions	-\$1.21	-\$1.08	-\$0.93	-\$0.76	-\$0.61	-\$0.92

Largely as a result of the decrease in population and GDP, state government expenditures **decrease** by an average of **\$2.7 million** over and above the **\$180.0 million decrease** in expenditures corresponding with the tax cut for a total decrease of **\$182.7 million**. Thus, the average annual change in net revenue is an increase of approximately **\$600,000**.

The results shown below are differences from the baseline REMI forecast.

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S4 - Direct Private Non-Farm Production Cost Decrease with Direct State Expenditure Decrease

Results	Units	2019	2020	2021	2022	2023	Average
Population	Individuals	-402	-555	-559	-467	-321	-461
Total Employment	Individuals	-1,751	-1,272	-898	-592	-359	-975
Government Employment	Individuals	-1,384	-1,348	-1,302	-1,246	-1,194	-1,295
Private Non-Farm Employment	Individuals	-367	76	404	654	834	320
Gross State Product (Value-Added)	Nominal Millions	-\$120.6	-\$89.3	-\$63.5	-\$41.1	-\$22.8	-\$67.5
Output (Industry Sales)	Nominal Millions	-\$199.1	-\$140.7	-\$92.8	-\$51.6	-\$17.8	-\$100.4
Disposable Personal Income	Nominal Millions	-\$79.7	-\$71.1	-\$61.3	-\$50.5	-\$40.2	-\$60.6
Government Revenue	Nominal Millions	-\$183.4	-\$182.7	-\$182.1	-\$181.5	-\$180.9	-\$182.1
Government Expenditure	Nominal Millions	-\$181.6	-\$182.6	-\$183.0	-\$183.2	-\$183.1	-\$182.7
NET REVENUE (Gov Rev, less Gov Exp)	Nominal Millions	-\$1.7	-\$0.2	\$0.9	\$1.7	\$2.3	\$0.6

Scenario 5

The fifth scenario treats 100% of the personal income tax cut as a direct decrease in personal income taxes.

The annual **increase** in Arkansas' population rises from 1,108 in 2019 to 3,417 in 2023, with a 5-year average annual **increase** of 2,448. This is largely driven by higher after-tax compensation rates raising the level of economic in-migration.

Total employment **rises** by an average of 1,593, of which 90.0% comes from private non-farm sectors and 10.0% comes from the government sector. Additionally, Gross State Product (GSP) and total output (which accounts for both GSP as well as the value of intermediate inputs) increase by an average of \$123.1 million and \$202.4 million, respectively. This increase in economic activity is driven mainly by two key factors: (1) the influx of new population; and (2) the increase in disposable personal income generated by lower personal income taxes. Specifically, disposable personal income **increases** by an average of \$280.7 million.

The static impact of the tax cut is a \$180.0 million **loss** in state revenue per year, but the increase in economic activity partially offsets the loss. Thus, the total revenue **loss** averages \$169.8 million. This means that 5.7% of the static revenue loss is recovered. The dynamic income tax revenue impact by bracket is:

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S5 - Dynamic Personal Income Tax Revenue Impact by Income Bracket

Income Bracket	Units	2019	2020	2021	2022	2023	Average
\$0 - \$4,299	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$4,300 - \$8,399	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$8,400 - \$12,599	Nominal Millions	\$0.00	\$0.01	\$0.01	\$0.01	\$0.01	\$0.01
\$12,600 - \$20,999	Nominal Millions	\$0.04	\$0.05	\$0.06	\$0.06	\$0.06	\$0.05
\$21,000 - \$35,099	Nominal Millions	\$0.15	\$0.19	\$0.22	\$0.23	\$0.24	\$0.21
\$35,100 - \$80,000	Nominal Millions	\$0.47	\$0.62	\$0.71	\$0.75	\$0.76	\$0.66
\$80,000+	Nominal Millions	\$1.06	\$1.40	\$1.61	\$1.70	\$1.72	\$1.50

Largely as a result of the increase in population and GDP, state government expenditures rise by an average of \$4.9 million.

The results shown below are differences from the baseline REMI forecast.

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S5 - Direct Personal Income Tax Decrease							
Results	Units	2019	2020	2021	2022	2023	Average
Population	Individuals	1,108	1,972	2,637	3,107	3,417	2,448
Total Employment	Individuals	1,440	1,671	1,713	1,631	1,507	1,593
Government Employment	Individuals	89	144	176	190	195	159
Private Non-Farm Employment	Individuals	1,351	1,527	1,537	1,441	1,313	1,434
Gross State Product (Value-Added)	Nominal Millions	\$103.8	\$124.4	\$131.9	\$130.5	\$125.0	\$123.1
Output (Industry Sales)	Nominal Millions	\$172.1	\$205.6	\$217.0	\$213.6	\$203.5	\$202.4
Disposable Personal Income	Nominal Millions	\$250.4	\$273.9	\$288.0	\$294.9	\$296.4	\$280.7
Government Revenue	Nominal Millions	-\$171.6	-\$170.3	-\$169.4	-\$169.0	-\$168.8	-\$169.8
Government Expenditure	Nominal Millions	\$2.1	\$3.8	\$5.2	\$6.3	\$7.0	\$4.9
NET REVENUE (Gov Rev, less Gov Exp)	Nominal Millions	-\$173.7	-\$174.1	-\$174.6	-\$175.2	-\$175.7	-\$174.7

Scenario 6

The sixth scenario also treats 100% of the personal income tax cut as a direct decrease in personal income taxes. In addition, this scenario accounts for a cut in general state government expenditures equal to the size of the personal income tax cut.

The annual **decline** in Arkansas' population **rises** from **20** in 2019 to **167** in 2023, with a 5-year average annual **decrease** of **80**. This is largely driven by higher after-tax compensation rates raising the level of economic in-migration.

Total employment **decreases** by an average of **1,504**, of which **14.0%** comes from private non-farm sectors and **86.0%** comes from the government sector. Additionally, Gross State Product (GSP) and total output (which accounts for both GSP as well as the value of intermediate inputs) **decrease** by an average of **\$101.7 million** and **\$171.8 million**, respectively. This **decrease** in economic activity is driven mainly by the **decrease** in in-state consumption that comes from two key factors: (1) the decrease in population; and (2) a portion of consumers' increased after-tax income being spent on out-of-state goods and services. Specifically, disposable personal income will **increase** by an average of **\$106 million**.

The static impact of the tax cut is a **\$180.0 million loss** in state revenue per year, but the increase in economic activity created by the increase in consumer after-tax personal income generates an average increase in annual revenue of **\$244,000**. Thus, the total revenue decrease under dynamic scoring averages approximately

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Proposals Under Consideration: Income Tax Proposal – Governor’s Proposal

-\$179.8 million. This means that 0.1% of the static revenue loss is recovered. The dynamic income tax revenue impact by bracket is:

S6 - Dynamic Personal Income Tax Revenue Impact by Income Bracket

Income Bracket	Units	2019	2020	2021	2022	2023	Average
\$0 - \$4,299	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$4,300 - \$8,399	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$8,400 - \$12,599	Nominal Millions	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
\$12,600 - \$20,999	Nominal Millions	-\$0.04	-\$0.04	-\$0.04	-\$0.04	-\$0.05	-\$0.04
\$21,000 - \$35,099	Nominal Millions	-\$0.14	-\$0.14	-\$0.15	-\$0.16	-\$0.17	-\$0.15
\$35,100 - \$80,000	Nominal Millions	-\$0.45	-\$0.46	-\$0.49	-\$0.52	-\$0.56	-\$0.50
\$80,000+	Nominal Millions	-\$1.03	-\$1.05	-\$1.11	-\$1.19	-\$1.27	-\$1.13

Largely as a result of the relative decrease in population, state government expenditures **decrease** by an average of **\$2.5 million** over and above the **\$180.0 million** decrease that corresponds to the tax cut.

The results shown below are differences from the baseline REMI forecast.

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Proposals Under Consideration: Income Tax Proposal – Governor's Proposal

S6 - Direct Personal Income Tax Decrease with Direct State Expenditure Decrease

Results	Units	2019	2020	2021	2022	2023	Average
Population	Individuals	-20	-37	-65	-111	-167	-80
Total Employment	Individuals	-1,673	-1,518	-1,462	-1,438	-1,430	-1,504
Government Employment	Individuals	-1,361	-1,327	-1,295	-1,258	-1,225	-1,293
Private Non-Farm Employment	Individuals	-312	-192	-168	-180	-204	-211
Gross State Product (Value-Added)	Nominal Millions	-\$107.9	-\$99.6	-\$98.4	-\$100.1	-\$102.7	-\$101.7
Output (Industry Sales)	Nominal Millions	-\$184.8	-\$169.6	-\$166.2	-\$167.7	-\$170.8	-\$171.8
Disposable Personal Income	Nominal Millions	\$112.7	\$111.1	\$107.0	\$102.2	\$97.0	\$106.0
Government Revenue	Nominal Millions	-\$179.5	-\$179.5	-\$179.7	-\$179.9	-\$180.2	-\$179.8
Government Expenditure	Nominal Millions	-\$181.0	-\$181.8	-\$182.5	-\$183.2	-\$183.7	-\$182.5
NET REVENUE (Gov Rev, less Gov Exp)	Nominal Millions	\$1.5	\$2.4	\$2.9	\$3.2	\$3.6	\$2.7

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Proposals Under Consideration: Income Tax Proposal – Governor’s Proposal

Conclusion:

The Governor is proposing to lower the tax rate from 6.9 percent to 6 percent for people with taxable incomes with \$80,000 or more. This impact statement provides a range of possible effects on the state economy and budget that would result from adopting the proposal. By factoring in the total economic effects, dynamic scoring can indicate where the state may recover revenue reduced by cuts in tax rates.

As described above, the scenarios reflect three different approaches – one focused on production costs, another on income, and a third one that blends production and income based on publicly available data.

The blended approach shows annual economic output growing on average over 5 years by \$209.6 million and an average annual increase of 1,646 jobs, with more than 90 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$174.9 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would be mostly concentrated in the public sector.

The production-cost approach reflects the potential for tax cuts to cause a reduction in costs for businesses, which in turn affect the economy in ways that an income-only approach may not capture. Since the Governor’s Proposal would affect after-tax wages and salaries, the plan would change the competitive position of Arkansas-based employers seeking to attract workers. Employers in the state have to compensate for the tax burden in order to compete with employers based in lower-tax states.

The production-cost approach shows annual economic output growing on average over 5 years by \$274.0 million and an average annual increase of 2,124 jobs, with more than 92 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$176.8 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would be concentrated in the public sector while the private sector would gain jobs.

The income-focused approach shows annual economic output growing on average over 5 years by \$202.4 million and an average annual increase of 1,593 jobs, with 90 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$174.7 million in revenue. Corresponding cuts in government spending would compensate for this loss. Output and job growth would turn negative, though the job loss would be mostly concentrated in the public sector.

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Legislative Impact Statement

Proposals Under Consideration: Corporate Income Tax Proposal

Executive Summary:

The proposal under consideration reduces the top marginal corporate income tax rate for individuals from six and five-tenths percent (6.5%) to six percent (6%). The total static fiscal impact of the proposal is a reduction in Arkansas state corporate income tax revenue of \$32,000,000.

This impact statement includes fiscal, economic, and demographic estimates from a dynamic economic model. A dynamic model captures the macroeconomic feedback from behavioral changes among consumers and businesses and allows this to have feedback effects on state revenues and expenditures.

The results show annual economic output growing on average over 5 years by \$46.3 million and an average annual increase of 356 jobs, with more than 93 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$30.8 million in revenue.

Methodology:

The economic and fiscal analysis of the proposals is conducted by Regional Economic Models, Inc. (REMI) using their Tax-PI v2.1 software, which is a dynamic regional macroeconomic, demographic, and fiscal model. Specifically, they use a 1-region custom model of Arkansas that is calibrated to revenues and expenditures from the FY 2017 Arkansas state budget.

Each budget category is assigned both an "economic driver" that allows it to respond to changes in a specific economic variable (e.g., Value Added for Corporate Income Tax Revenue) and a "policy variable" that allows it to directly impact a specific economic variable (e.g., Production Cost for Corporate Income Tax Revenue).

The static corporate income tax revenue impact and the resulting direct economic shock are input into the model for each year during the 5-year period 2019-2023. The economic shock is a decrease in production costs for all applicable industries. Then, the model produces estimates for each proposal of economic impacts on the state of Arkansas such as employment, GDP, output, and disposable personal income, demographic impacts on the state such as changes in population, and fiscal impacts on the state budget including both revenues and expenditures.

The results are reported in the next section with accompanying discussion.

Economic & Fiscal Impacts:

The annual **increase** in Arkansas' population rises from **101** in 2019 to **436** in 2023, with a 5-year average annual **increase** of **279**. This is largely driven by higher employment opportunities, which raises the level of economic in-migration.

Total employment **rises** by an average of **356**, of which **93.5%** comes from private non-farm sectors and **6.5%** comes from the government sector. Additionally, Gross State Product (GSP) and total output (which accounts for both GSP as well as the value of intermediate inputs) **increase** by an average of **\$26.5 million** and **\$46.3 million**, respectively. This increase in economic activity is driven mainly by two key factors: (1) the influx of new population; and (2) the decrease in business costs which makes Arkansas industries more competitive with imports. Disposable personal income **increases** by an average of **\$16.9 million**.

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Legislative Impact Statement

Proposals Under Consideration: Corporate Income Tax Proposal

The static impact of the tax cut is a **\$32.0 million loss** in state revenue per year, but the increase in economic activity partially offsets the loss. Thus, the total revenue **loss averages \$30.8 million**. This means that **3.8%** of the static revenue loss is recovered.

Largely as a result of the increase in population and GDP, state government expenditures **rise** by an average of approximately **\$600,000**.

The results shown below are differences from the baseline REMI forecast.

Corporate Income Tax Change: Revenue and Production Costs Decrease by \$32M							
Results	Units	2019	2020	2021	2022	2023	Average
Population	Individuals	101	198	289	368	436	279
Total Employment	Individuals	233	324	382	413	429	356
Government Employment	Individuals	10	19	25	30	34	24
Private Non-Farm Employment	Individuals	223	305	357	383	396	333
Gross State Product (Value-Added)	Nominal Millions	\$15.6	\$22.8	\$28.0	\$31.7	\$34.3	\$26.5
Output (Industry Sales)	Nominal Millions	\$27.1	\$39.8	\$49.0	\$55.4	\$60.0	\$46.3
Disposable Personal Income	Nominal Millions	\$8.9	\$13.8	\$17.7	\$20.8	\$23.3	\$16.9
Government Revenue	Nominal Millions	-\$31.3	-\$31.0	-\$30.8	-\$30.6	-\$30.4	-\$30.8
Government Expenditure	Nominal Millions	\$0.2	\$0.4	\$0.6	\$0.8	\$1.0	\$0.6
NET REVENUE (Gov Rev, less Gov Exp)	Nominal Millions	-\$31.5	-\$31.4	-\$31.4	-\$31.4	-\$31.4	-\$31.4

Conclusion:

The proposal under consideration reduces the top marginal corporate income tax rate for individuals from six and five-tenths percent (6.5%) to six percent (6%). This impact statement provides the possible effects on the state economy and budget that would result from adopting the proposal. By factoring in the total economic effects, dynamic scoring can indicate where the state may recover revenue reduced by cuts in tax rates.

The results show annual economic output growing on average over 5 years by \$46.3 million and an average annual increase of 356 jobs, with more than 93 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$30.8 million in revenue.

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Legislative Impact Statement

Proposals Under Consideration: Throwback Rule Repeal Proposal

Executive Summary:

The proposal under consideration repeals the Arkansas Throwback Rule, in which Arkansas business' out-of-state sales that are not taxed by any other jurisdiction are "thrown back" to be taxed by Arkansas. The total static fiscal impact of the proposal is a reduction in Arkansas state corporate income tax revenue of \$25,000,000.

This impact statement includes fiscal, economic, and demographic estimates from a dynamic economic model. A dynamic model captures the macroeconomic feedback from behavioral changes among consumers and businesses and allows this to have feedback effects on state revenues and expenditures.

The results show annual economic output growing on average over 5 years by \$28.7 million and an average annual increase of 152 jobs, with more than 92 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$24.5 million in revenue.

Methodology:

The economic and fiscal analysis of the proposals is conducted by Regional Economic Models, Inc. (REMI) using their Tax-PI v2.1 software, which is a dynamic regional macroeconomic, demographic, and fiscal model. Specifically, they use a 1-region custom model of Arkansas that is calibrated to revenues and expenditures from the FY 2017 Arkansas state budget.

Each budget category is assigned both an "economic driver" that allows it to respond to changes in a specific economic variable (e.g., Value Added for Corporate Income Tax Revenue) and a "policy variable" that allows it to directly impact a specific economic variable (e.g., Production Cost for Corporate Income Tax Revenue).

The static corporate income tax revenue impact and the resulting direct economic shock are input into the model for each year during the 5-year period 2019-2023. The economic shock is a decrease in production costs for all applicable industries. Then, the model produces estimates for each proposal of economic impacts on the state of Arkansas such as employment, GDP, output, and disposable personal income, demographic impacts on the state such as changes in population, and fiscal impacts on the state budget including both revenues and expenditures.

The results are reported in the next section with accompanying discussion.

Economic & Fiscal Impacts:

The annual **increase** in Arkansas' population rises from 37 in 2019 to 181 in 2023, with a 5-year average annual **increase** of 111. This is largely driven by higher employment opportunities, which raises the level of economic in-migration.

Total employment **rises** by an average of 152, of which 92.8% comes from private non-farm sectors and 7.2% comes from the government sector. Additionally, Gross State Product (GSP) and total output (which accounts for both GSP as well as the value of intermediate inputs) **increase** by an average of \$14.5 million and \$28.7 million, respectively. This increase in economic activity is driven mainly by two key factors: (1) the influx of new population; and (2) the decrease in business costs which makes Arkansas industries more competitive with imports. Disposable personal income **increases** by an average of \$8.0 million.

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Proposals Under Consideration: Throwback Rule Repeal Proposal

The static impact of the tax cut is a **\$25.0 million loss** in state revenue per year, but the increase in economic activity partially offsets the loss. Thus, the total revenue **loss averages \$24.5 million**. This means that **2%** of the static revenue loss is recovered.

Largely as a result of the increase in population and GDP, state government expenditures **rise** by an average of approximately **\$300,000**.

The results shown below are differences from the baseline REMI forecast.

Throwback Rule Repeal: Revenue and Production Costs Decrease by \$25M							
Results	Units	2019	2020	2021	2022	2023	Average
Population	Individuals	37	76	114	149	181	111
Total Employment	Individuals	88	132	163	182	194	152
Government Employment	Individuals	4	8	12	15	17	11
Private Non-Farm Employment	Individuals	83	124	152	168	177	141
Gross State Product (Value-Added)	Nominal Millions	\$7.4	\$11.8	\$15.3	\$18.0	\$20.0	\$14.5
Output (Industry Sales)	Nominal Millions	\$14.3	\$23.2	\$30.3	\$35.7	\$39.9	\$28.7
Disposable Personal Income	Nominal Millions	\$3.8	\$6.3	\$8.4	\$10.2	\$11.6	\$8.0
Government Revenue	Nominal Millions	-\$24.7	-\$24.6	-\$24.4	-\$24.3	-\$24.2	-\$24.5
Government Expenditure	Nominal Millions	\$0.1	\$0.2	\$0.3	\$0.3	\$0.4	\$0.3
NET REVENUE (Gov Rev, less Gov Exp)	Nominal Millions	-\$24.8	-\$24.7	-\$24.7	-\$24.7	-\$24.7	-\$24.7

Conclusion:

The proposal under consideration repeals the Arkansas Throwback Rule. This impact statement provides the possible effects on the state economy and budget that would result from adopting the proposal. By factoring in the total economic effects, dynamic scoring can indicate where the state may recover revenue reduced by cuts in tax rates.

The results show annual economic output growing on average over 5 years by \$28.7 million and an average annual increase of 152 jobs, with more than 92 percent of the growth occurring in private non-farm employment. It also shows a net loss of \$24.5 million in revenue.

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Legislative Impact Statement

Proposals Under Consideration: Single Sales Factor Proposal

Executive Summary:

The proposal under consideration amends the Arkansas corporate income tax base by implementing a Single Sales Factor. This apportionment system only considers the percentage of sales that occur within the state of Arkansas to determine each corporation's percentage of net income that is taxable in Arkansas, while the current apportionment system also factors in the corporation's percentages of payroll and property that exist in Arkansas.¹

This impact statement includes fiscal, economic, and demographic estimates from a dynamic economic model. A dynamic model captures the macroeconomic feedback from behavioral changes among consumers and businesses and allows this to have feedback effects on state revenues and expenditures.

The results show annual economic output falling on average over 5 years by \$13.8 million and an average annual decrease of 94 jobs, with more than 91 percent of the decline occurring in private non-farm employment. It also shows a net increase of \$8.6 million in revenue.

Methodology:

The economic and fiscal analysis of the proposals is conducted by Regional Economic Models, Inc. (REMI) using their Tax-PI v2.1 software, which is a dynamic regional macroeconomic, demographic, and fiscal model. Specifically, they use a 1-region custom model of Arkansas that is calibrated to revenues and expenditures from the FY 2017 Arkansas state budget.

Each budget category is assigned both an "economic driver" that allows it to respond to changes in a specific economic variable (e.g., Value Added for Corporate Income Tax Revenue) and a "policy variable" that allows it to directly impact a specific economic variable (e.g., Production Cost for Corporate Income Tax Revenue).

The static corporate income tax revenue impact and the resulting direct economic shock are input into the model for each year during the 5-year period 2019-2023. The economic shock is an increase in production costs for all applicable industries. Then, the model produces estimates for each proposal of economic impacts on the state of Arkansas such as employment, GDP, output, and disposable personal income, demographic impacts on the state such as changes in population, and fiscal impacts on the state budget including both revenues and expenditures.

The results are reported in the next section with accompanying discussion.

Economic & Fiscal Impacts:

The annual **decrease** in Arkansas' population rises from **34** in 2019 to **147** in 2023, with a 5-year average annual **decrease** of **94**. This is largely driven by lower employment opportunities, which lowers the level of economic in-migration.

Total employment **falls** by an average of **94**, of which **91.5%** comes from private non-farm sectors and **8.5%** comes from the government sector. Additionally, Gross State Product (GSP) and total output (which accounts for both GSP as well as the value of intermediate inputs) **decrease** by an average of **\$8.1 million** and **\$13.8**

¹ Currently, the sales factor has double the weight of each of the payroll and property factors.

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Proposals Under Consideration: Single Sales Factor Proposal

million, respectively. This decrease in economic activity is driven mainly by two key factors: (1) the loss of new population; and (2) the increase in business costs which makes Arkansas industries less competitive with imports. Disposable personal income **decreases** by an average of **\$5.4 million**.

The static impact of the tax cut is a **\$9.0 million gain** in state revenue per year, but the decrease in economic activity partially offsets the gain. Thus, the total revenue **gain averages \$8.6 million**. This means that **4.4%** of the static revenue gain is lost.

Largely as a result of the decrease in population and GDP, state government expenditures **fall** by an average of approximately **\$200,000**.

The results shown below are differences from the baseline REMI forecast.

Single Sales Factor Enactment: Revenue and Production Costs Increase by \$9M

Results	Units	2019	2020	2021	2022	2023	Average
Population	Individuals	-34	-67	-98	-125	-147	-94
Total Employment	Individuals	-62	-86	-101	-109	-112	-94
Government Employment	Individuals	-3	-6	-8	-10	-11	-8
Private Non-Farm Employment	Individuals	-58	-80	-93	-99	-101	-86
Gross State Product (Value-Added)	Nominal Millions	-\$4.8	-\$7.0	-\$8.6	-\$9.7	-\$10.5	-\$8.1
Output (Industry Sales)	Nominal Millions	-\$8.1	-\$11.9	-\$14.6	-\$16.5	-\$17.7	-\$13.8
Disposable Personal Income	Nominal Millions	-\$2.8	-\$4.4	-\$5.7	-\$6.7	-\$7.4	-\$5.4
Government Revenue	Nominal Millions	\$8.8	\$8.7	\$8.6	\$8.5	\$8.5	\$8.6
Government Expenditure	Nominal Millions	-\$0.1	-\$0.1	-\$0.2	-\$0.3	-\$0.3	-\$0.2
<u>NET REVENUE</u> (Gov Rev, less Gov Exp)	Nominal Millions	\$8.8	\$8.8	\$8.8	\$8.8	\$8.8	\$8.8

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Proposals Under Consideration: Single Sales Factor Proposal

Conclusion:

The proposal under consideration amends the Arkansas corporate income tax base by implementing a Single Sales Factor. This impact statement provides the possible effects on the state economy and budget that would result from adopting the proposal. By factoring in the total economic effects, dynamic scoring can indicate where the state may recover revenue reduced by cuts in tax rates.

The results show annual economic output falling on average over 5 years by \$13.8 million and an average annual decrease of 94 jobs, with more than 91 percent of the decline occurring in private non-farm employment. It also shows a net increase of \$8.6 million in revenue.

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Proposals Under Consideration: Inventory Tax Repeal Proposal

Executive Summary:

The proposal under consideration repeals the Arkansas inventory tax. There is no direct static fiscal impact of the proposal on the Arkansas state budget because the inventory tax falls under local property taxes, which decrease by \$70,000,000. While the state budget is not directly impacted in the analysis, it is acknowledged that given the decrease in local property taxes, K-12 education funding discrepancies may arise between counties that the state government may need to step in to equalize.

This impact statement includes fiscal, economic, and demographic estimates from a dynamic economic model. A dynamic model captures the macroeconomic feedback from behavioral changes among consumers and businesses and allows this to have feedback effects on state revenues and expenditures.

The results show annual economic output growing on average over 5 years by \$88.1 million and an average annual increase of 488 jobs, with more than 91 percent of the growth occurring in private non-farm employment. It also shows a net gain of \$2.8 million in state revenue.

Methodology:

The economic and fiscal analysis of the proposals is conducted by Regional Economic Models, Inc. (REMI) using their Tax-PI v2.1 software, which is a dynamic regional macroeconomic, demographic, and fiscal model. Specifically, they use a 1-region custom model of Arkansas that is calibrated to revenues and expenditures from the FY 2017 Arkansas state budget.

Each budget category is assigned both an "economic driver" that allows it to respond to changes in a specific economic variable (e.g., Value Added for Corporate Income Tax Revenue) and a "policy variable" that allows it to directly impact a specific economic variable (e.g., Production Cost for Corporate Income Tax Revenue).

The direct economic shock is input into the model for each year during the 5-year period 2019-2023. The economic shock is a decrease in production costs for all applicable industries. Then, the model produces estimates for each proposal of economic impacts on the state of Arkansas such as employment, GDP, output, and disposable personal income, demographic impacts on the state such as changes in population, and fiscal impacts on the state budget including both revenues and expenditures.

The results are reported in the next section with accompanying discussion.

Economic & Fiscal Impacts:

The annual **increase** in Arkansas' population rises from **183** in 2019 to **789** in 2023, with a 5-year average annual **increase** of **506**. This is largely driven by higher employment opportunities, which raises the level of economic in-migration.

Total employment **rises** by an average of **488**, of which **91.4%** comes from private non-farm sectors and **8.6%** comes from the government sector. Additionally, Gross State Product (GSP) and total output (which accounts for both GSP as well as the value of intermediate inputs) **increase** by an average of **\$47.0 million** and **\$88.1 million**, respectively. This increase in economic activity is driven mainly by two key factors: (1) the influx of new population; and (2) the decrease in business costs which makes Arkansas industries more competitive with imports. Disposable personal income **increases** by an average of **\$28.9 million**.

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Proposals Under Consideration: Inventory Tax Repeal Proposal

The static impact of the tax cut is **\$0.0 million** in state revenue per year, but the increase in economic activity generates a gain in state revenue. Thus, the total state revenue **gain averages \$2.8 million**.

Largely as a result of the increase in population and GDP, state government expenditures rise by an average of **\$1.1 million**.

The results shown below are differences from the baseline REMI forecast.

Inventory Tax Repeal: Production Costs Decrease by \$70M

Results	Units	2019	2020	2021	2022	2023	Average
Population	Individuals	183	360	526	670	789	506
Total Employment	Individuals	314	442	525	570	591	488
Government Employment	Individuals	18	33	45	54	61	42
Private Non-Farm Employment	Individuals	296	409	480	515	530	446
Gross State Product (Value-Added)	Nominal Millions	\$26.2	\$39.6	\$49.7	\$57.1	\$62.5	\$47.0
Output (Industry Sales)	Nominal Millions	\$48.2	\$73.7	\$93.1	\$107.5	\$118.0	\$88.1
Disposable Personal Income	Nominal Millions	\$14.6	\$23.2	\$30.3	\$36.0	\$40.3	\$28.9
Government Revenue	Nominal Millions	\$1.9	\$2.5	\$2.9	\$3.2	\$3.5	\$2.8
Government Expenditure	Nominal Millions	\$0.4	\$0.7	\$1.1	\$1.5	\$1.8	\$1.1
NET REVENUE (Gov Rev, less Gov Exp)	Nominal Millions	\$1.6	\$1.7	\$1.8	\$1.8	\$1.8	\$1.7

Conclusion:

The proposal under consideration repeals the Arkansas inventory tax. This impact statement provides the possible effects on the state economy and budget that would result from adopting the proposal. By factoring in the total economic effects, dynamic scoring can indicate where the state may recover revenue reduced by cuts in tax rates.

The results show annual economic output growing on average over 5 years by \$88.1 million and an average annual increase of 488 jobs, with more than 91 percent of the growth occurring in private non-farm employment. It also shows a net gain of \$2.8 million in state revenue.

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Proposals Under Consideration: Franchise Tax Repeal Proposal

Executive Summary:

The proposal under consideration repeals the Arkansas franchise tax. The total static fiscal impact of the proposal is a reduction in Arkansas state tax revenue of \$29,000,000. Currently, all franchise tax revenue over \$8 million is put into a special revenue fund that is earmarked for K-12 education. Thus, the repeal is analyzed in combination with a decrease in general state government expenditures of \$21,000,000 to model the scenario in which the lost education funding is made up elsewhere in the state budget.

This impact statement includes fiscal, economic, and demographic estimates from a dynamic economic model. A dynamic model captures the macroeconomic feedback from behavioral changes among consumers and businesses and allows this to have feedback effects on state revenues and expenditures.

The results show annual economic output falling on average over 5 years by \$9.1 million and an average annual decrease of 149 jobs, but a small increase in private non-farm employment. It also shows a net loss of \$29.3 million in revenue.

Methodology:

The economic and fiscal analysis of the proposals is conducted by Regional Economic Models, Inc. (REMI) using their Tax-PI v2.1 software, which is a dynamic regional macroeconomic, demographic, and fiscal model. Specifically, they use a 1-region custom model of Arkansas that is calibrated to revenues and expenditures from the FY 2017 Arkansas state budget.

Each budget category is assigned both an "economic driver" that allows it to respond to changes in a specific economic variable (e.g., Value Added for Corporate Income Tax Revenue) and a "policy variable" that allows it to directly impact a specific economic variable (e.g., Production Cost for Corporate Income Tax Revenue).

The static tax revenue impact and the resulting direct economic shock and static expenditure impact are input into the model for each year during the 5-year period 2019-2023. The economic shock is a decrease in production costs for all applicable industries. Then, the model produces estimates for each proposal of economic impacts on the state of Arkansas such as employment, GDP, output, and disposable personal income, demographic impacts on the state such as changes in population, and fiscal impacts on the state budget including both revenues and expenditures.

The results are reported in the next section with accompanying discussion.

Economic & Fiscal Impacts:

The annual **decrease** in Arkansas' population rises from 60 in 2019 to 92 in 2023, with a 5-year average annual **decrease** of 89. This is largely driven by lower employment opportunities, which lowers the level of economic in-migration.

Total employment **falls** by an average of 149, though the decline is concentrated in the government sector and the private non-farm sectors see a small average increase in employment. Additionally, Gross State Product (GSP) and total output (which accounts for both GSP as well as the value of intermediate inputs) **decrease** by an average of \$6.1 million and \$9.1 million, respectively. This decrease in economic activity is driven mainly by two key factors: (1) the loss of new population; and (2) the decline in general state government

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expenditures. Disposable personal income **decreases** by an average of **\$8.2 million**.

The static impact of the tax cut is a **\$29.0 million loss** in state revenue per year, and the decrease in economic activity generates an additional loss. Thus, the total revenue **loss averages \$29.3 million**. This means that the static revenue **loss** is increased by another 1.0%.

Largely as a result of the decrease in population and GDP, state government expenditures **decrease** by an average of **\$400,000** over and above the **\$21.0 million decrease** in expenditures corresponding to the loss of K-12 funding for a total **decrease of \$21.4 million**.

The results shown below are differences from the baseline REMI forecast.

Franchise Tax Repeal: Revenue, Expenditures, and Production Costs Decrease by \$29M

Results	Units	2019	2020	2021	2022	2023	Average
Population	Individuals	-60	-90	-101	-101	-92	-89
Total Employment	Individuals	-230	-181	-142	-109	-85	-149
Government Employment	Individuals	-162	-158	-153	-146	-140	-152
Private Non-Farm Employment	Individuals	-68	-23	11	37	55	2
Gross State Product (Value-Added)	Nominal Millions	-\$13.5	-\$9.2	-\$5.6	-\$2.5	\$0.0	-\$6.1
Output (Industry Sales)	Nominal Millions	-\$22.5	-\$14.6	-\$8.0	-\$2.4	\$2.2	-\$9.1
Disposable Personal Income	Nominal Millions	-\$10.0	-\$9.2	-\$8.3	-\$7.2	-\$6.2	-\$8.2
Government Revenue	Nominal Millions	-\$29.4	-\$29.4	-\$29.3	-\$29.2	-\$29.2	-\$29.3
Government Expenditure	Nominal Millions	-\$21.2	-\$21.4	-\$21.4	-\$21.5	-\$21.5	-\$21.4
NET REVENUE (Gov Rev, less Gov Exp)	Nominal Millions	-\$8.2	-\$8.0	-\$7.9	-\$7.7	-\$7.7	-\$7.9

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Conclusion:

The proposal under consideration repeals the Arkansas franchise tax. The repeal is analyzed in combination with a decrease in general state government expenditures to model the scenario in which the lost education funding is made up elsewhere in the state budget. This impact statement provides the possible effects on the state economy and budget that would result from adopting the proposal. By factoring in the total economic effects, dynamic scoring can indicate where the state may recover revenue reduced by cuts in tax rates.

The results show annual economic output falling on average over 5 years by \$9.1 million and an average annual decrease of 149 jobs, but a small increase in private non-farm employment. It also shows a net loss of \$29.3 million in revenue.

Appendix B

\$200 Million Tax Cut Package

Choose from the following proposals that have been voted on by the task force for further study to indicate your priority of tax cuts. Write in the amount to dedicate to the proposal categories of your choice. Total amount may not be greater than a \$200 million impact.

Net Operating Loss (NOL)

NOL to 10 years: \$0 until year 8; \$16.7 M → \$64.8 M at year 16

NOL to 20 years: \$0 until year 6; \$16.7 M → \$158 M at year 35

Repeal steel NOL and all to 20 years: \$0 until year 6; \$16.7 M → \$129 M at year 20

Conform to Federal NOL: \$7 M → \$119 M at year 25

Amount to dedicate towards NOL:

Individual Income Top Rate Reduction

5.00% – \$486 M

5.00% and 0% below \$4,299 – \$497 M

5.75% and 0% below \$15,000 – \$974 M

5.90% – \$225 M

6.00% – \$180 M

Amount to dedicate towards individual income top rate reduction:

Simplification of Individual Income Tax Brackets and Tables

Option A _____

Option B _____

Corporate Income Rate Reduction

\$0-\$50,000 (3.5%); \$50,001+ (5.75%) – \$53 M

5.90% – \$39 M

Amount to dedicate towards corporate income rate reduction:

Earned Income Tax Credit (EITC)

5% of the federal EITC – \$40 M

10% of the federal EITC – \$77.7 M

Amount to dedicate towards EITC:

(Continued on the next page)

Standard Deduction

Raise to \$2,500 – \$7.7 M

Replace with an exemption (itemized deductions still allowed) – \$4.6 M

Adopt federal (Tax Cuts and Jobs Act) – \$257.7-333.7 M

Amount to dedicate towards standard deduction:

Throwback Rule and Apportionment-Single Sales Factor

(these have been paired for a net revenue impact of \$15.7 M)

Throwback rule – \$24.5 M impact

Apportionment – single sales factor – \$8.8 M increase

Amount to dedicate to throwback rule and apportionment:

Total amount to dedicate to a tax cut package:

(Cannot exceed \$200 million)

Appendix D

Revenue Increases

Please rank your top five priorities out of the following increases to revenue, with 1 representing the highest priority.

Note that these increases to revenue will be used to offset tax cuts elsewhere.

- _____ Repeal Exemptions Less Than \$10,000 (Sales Tax Proposal #16)
\$41,000 increase
- _____ Repeal Exemption on the Sale of Magazine Subscriptions (Sales Tax Proposal #41)
\$1.6 M increase
- _____ Require Sales Tax Collections by Remote Sellers (Sales Tax Proposal #B)
\$35.4 M total increase; \$24.5 to General Revenue
- _____ Repeal Exemption for Capital Gains over \$10 M (Income Tax Proposal #21)
\$4.7 M increase
- _____ Repeal Income Tax Credit for Political Contributions (Income Tax Proposal #29)
Unable to determine
- _____ Create Excise Tax on E-Cigarettes (Excise Tax Proposal #2)
\$12 M increase
- _____ Increase the Excise Tax Cigarettes (Excise Tax Proposals #4-5)
To be determined based on healthcare costs associated with smoking
For reference: 15¢ increase = \$26 M increase; 50¢ increase = \$77 M increase
- _____ Create a Special Excise Tax on Retail Sales of Alcoholic Beverages, Cigarettes, E-Cigarettes, and Other Tobacco Products (Excise Tax Proposals #8)
\$32 M total increase
- _____ Index Fuel Taxes (Excise Tax Proposal #11)
Unable to determine
- _____ Create a Road User Fee for Electric and Hybrid Vehicles (Excise Tax Proposal #14)
\$1.1 M increase, if the fees are set at \$184 for electric cars and \$90 for hybrids

Appendix E

Revenue Increase Priorities Table

<u>Proposal</u>	<u>Total Rank Score</u>	<u>Final Ranking</u>
Remote Sellers	28	1
Capital Gains > 10M	47	2
ITC Political Contributions	49	3
Road User Fee E/H	53	4
Magazine Subscriptions	65	5
Fuel Tax Indexing	66	6

