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# Oklahoma Task Force on Comprehensive Tax Reform

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# Intangible Property Tax

## BACKGROUND

- **Prior to 2009, intangible personal property only taxed via “unit valuation” of centrally businesses like railroads;**
- **OK Supreme Court upheld taxation of intangible personal property in S.W. Bell vs. State Board of Equalization (2009);**
  - Created possibility that localities would begin to tax some types of intangible property owned by other, locally-assessed entities.
- **SJR 61 (2010) provided stop-gap fix:**
  - Created Business Activity Tax in lieu of taxation of intangible personal property for 2010-2012;
  - Suspended franchise tax;
  - Capped BAT at 2010 franchise tax assessment amount.

# Intangible Property Tax

## **MOVING FORWARDS/MOVING BACKWARDS**

- **Doing away with taxation of intangible personal property for centrally-assessed entities could lead to substantial revenue loss and make assessments more difficult;**
- **Expanding taxation of intangible personal property owned by locally-assessed entities could lead to substantial tax increase on some businesses and make assessments more difficult;**
- **Optimal outcome is constitutional amendment to return to *status quo ante* : limiting taxation of intangible property to centrally-assessed entities.**



# Guiding Principles

**A well-designed tax system should be based on the following principles:**

## ✓Adequacy

- ✓ Raises enough revenue to sustain the level of public services demanded by citizens and policymakers

## ✓Equity

- ✓ Taxpayers in similar circumstances should pay similar amounts of tax ('horizontal equity')
- ✓ People with a greater ability to pay should pay more ('vertical equity')

## ✓Simplicity

- ✓ Tax policy should be easy to understand and enforce

## ✓Neutrality

- ✓ Tax policy should not favor one kind of economic policy over another

## ✓Balance

- ✓ Avoid over-reliance on any single tax

# Guiding Principles: Adequacy

## Is our Tax System ADEQUATE for our Needs?

### OKLAHOMA IS A LOW TAX STATE

- Oklahomans pay among the least amount of state and local taxes in the nation, either per capita (41st) or as share of state personal income (40th);
- Just under a dime of every dollar earned by Oklahomans goes to pay for state and local services.

<b>FY 2008</b>	<b>State &amp; Local Taxes as a % of Income</b>	<b>State &amp; Local Taxes per Capita</b>
<b>National Average</b>	<b>10.9%</b>	<b>\$4,371</b>
<b>Oklahoma</b>	<b>9.5%</b>	<b>\$3,379</b>
<b>Where Oklahoma RANKS</b>	<b>41st</b>	<b>40th</b>

Source: Source: Center on Budget and Policy Priorities tabulations based on data from the Bureau of the Census.

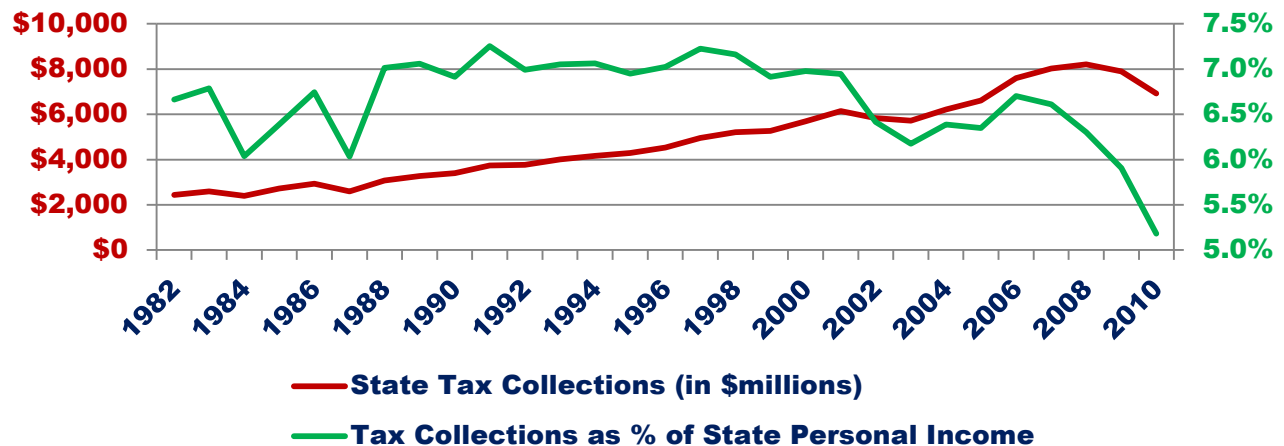
# Guiding Principles: Adequacy

## Is our Tax System ADEQUATE for our Needs?

### TAX COLLECTIONS AT HISTORIC LOWS

- Tax collections in FY '10 equal to just 5.2 percent of state personal income ;
- Declined from 6.7 percent in FY '06 due to both tax cuts and economic downturn.

State Tax Collections, FY '82 - FY '10  
Total and as % of State Personal Income



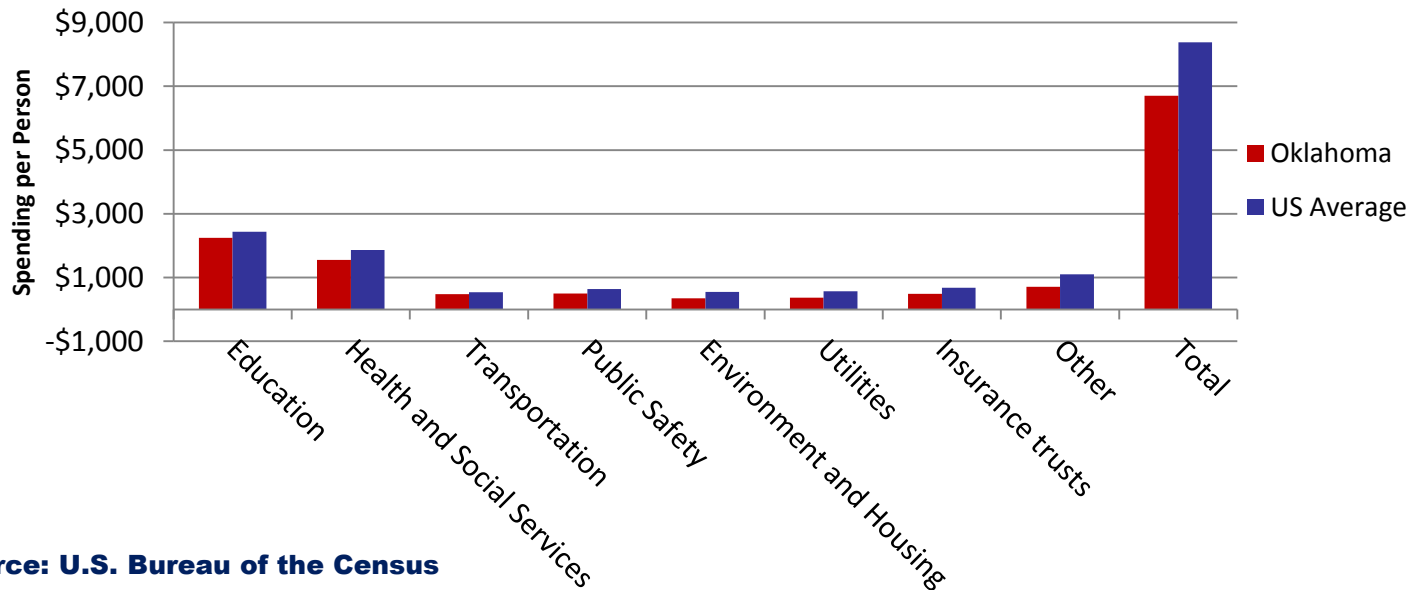
Sources: State personal income from Bureau of Economic Analysis; Tax collections from Annual Executive Budget

# Guiding Principles: Adequacy

## Is our Tax System ADEQUATE for our Needs?

- Total per capital state and local spending is \$1,627 (18 percent) less than the national average;
- We spend below the national average in just about every expenditure category.

State and Local Spending per Person by Function, 2007-08



Source: U.S. Bureau of the Census

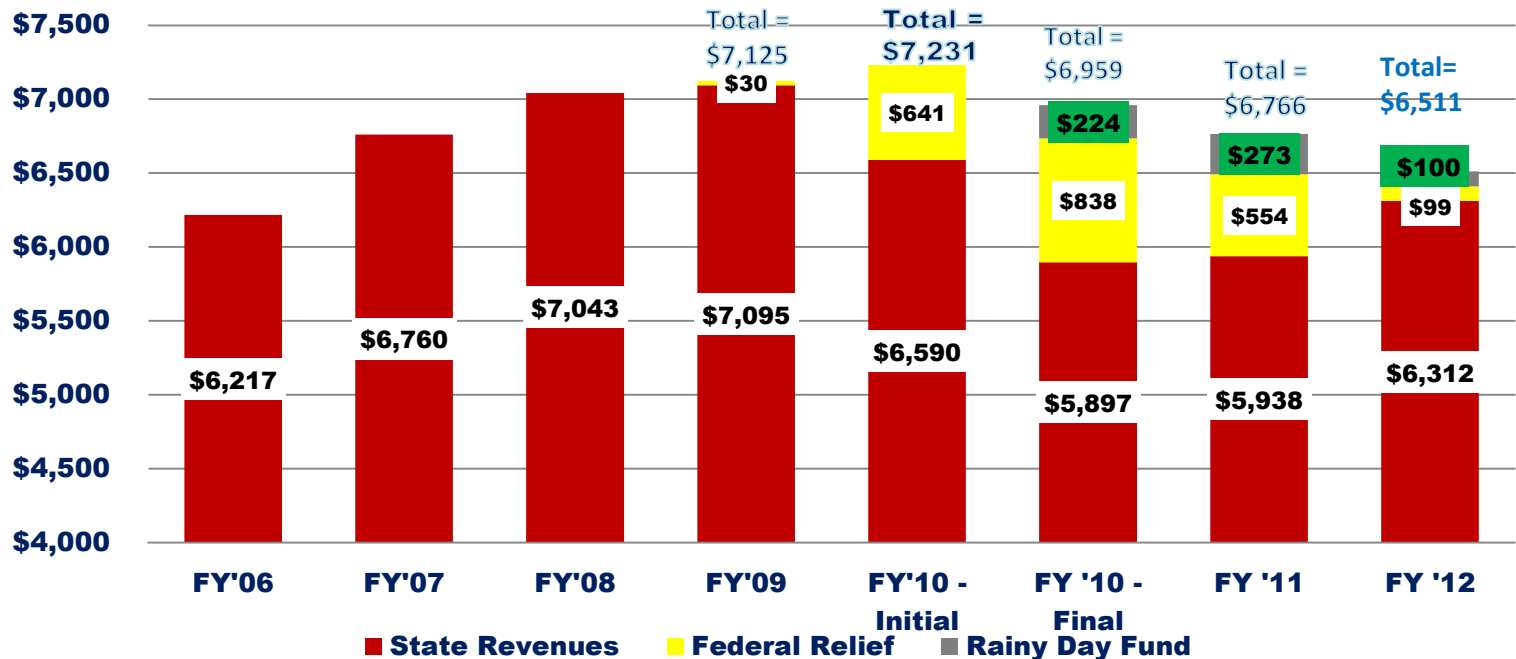
# Guiding Principles: Adequacy

## Is our Tax System ADEQUATE for our Needs?

- State appropriations in FY '12 down \$614 million, 8.6 percent, from FY '09;
- Many agencies cut >20 percent from pre-downturn levels.

### State Appropriations, FY '06- FY '12

(in \$ Millions, includes supplementals, excludes Rainy Day "spillover" funds)

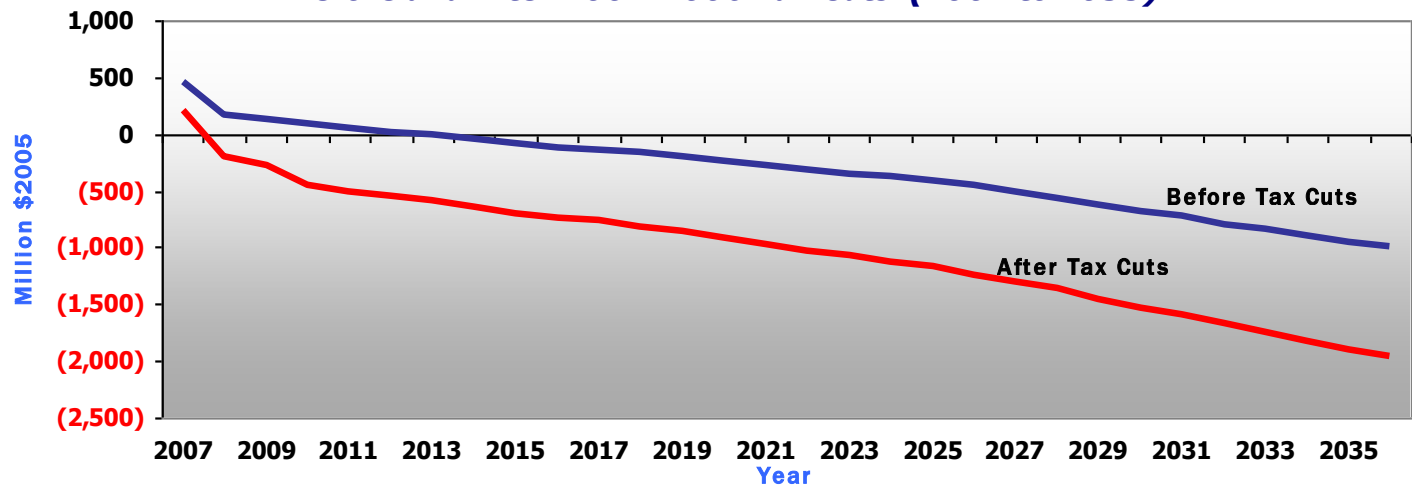


# Guiding Principles: Adequacy

## Is our Tax System ADEQUATE for our Needs?

- We face a long-term *structural budget deficit* – a growing misalignment between the cost of providing services and the revenues generated to pay for them.

Projected Annual Budget Surpluses and Deficits  
Before and After 2004-2006 Tax Cuts (2007 to 2035)



Source: Projections conducted in 2007 by Dr. Kent Olson, Professor of Economics, Oklahoma State University

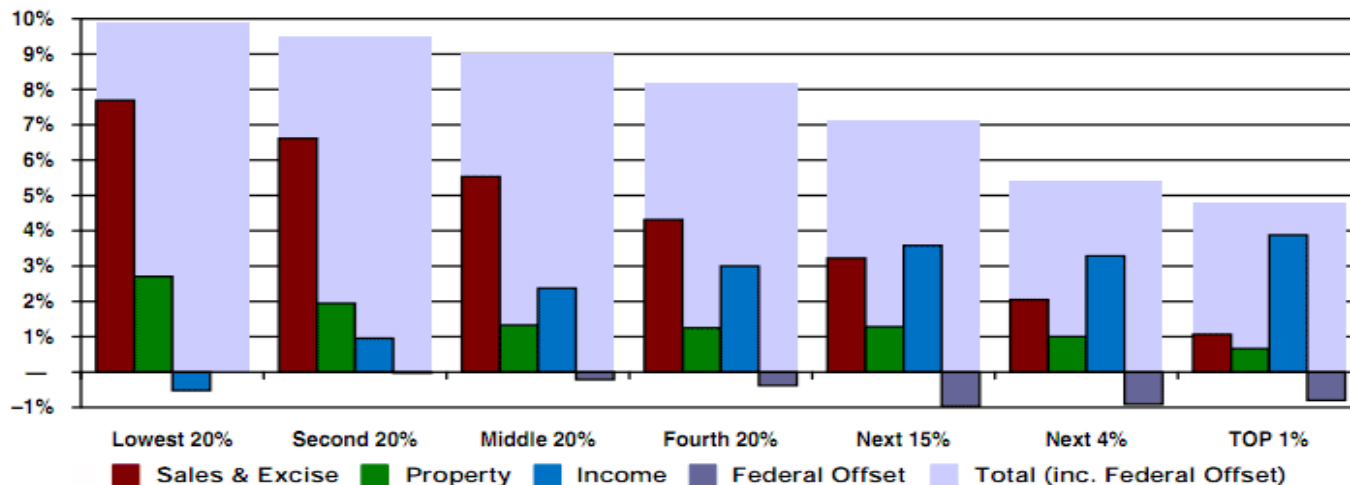
# Guiding Principles: Equity

## Is Oklahoma's Tax System Fair?

- **Low- and moderate-income Oklahomans pay a considerably higher share of their income in state and local taxes than do upper-income Oklahomans;**
- **Progressive effects of the income tax fail to offset fully the regressive effects of sales and property taxes.**

### State & Local Taxes in 2007

Shares of family income for non-elderly taxpayers



Source: Who Pays?: A Distributional Analysis of the Tax Systems of All 50 States, Third Edition  
Institute on Taxation and Economic Policy; [http://www.itepnet.org/state\\_reports/whopays.php](http://www.itepnet.org/state_reports/whopays.php)

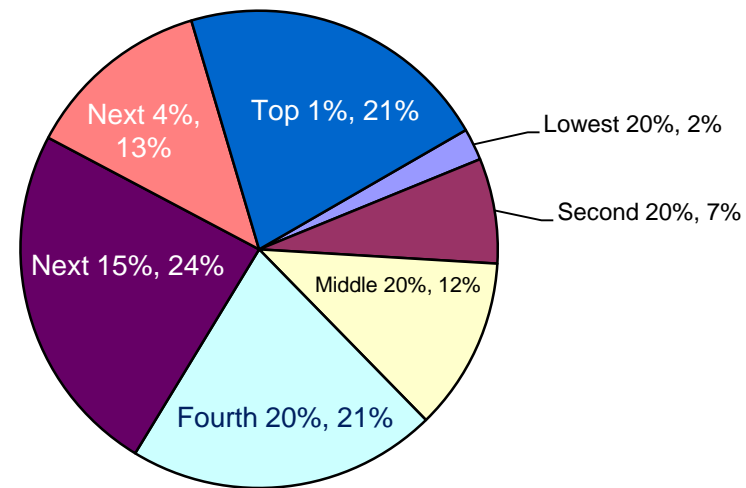
# Guiding Principles: Equity

## Is Oklahoma's Tax System Fair?

- Tax cuts of mid-2000's provided some benefit to lower-income households (increase in standard deduction) but primarily benefitted upper-income households;
- Of major income tax cuts, 21 percent of benefit went to top 1 percent, just 9 percent of benefits to bottom 40 percent.

Share of Total Tax Cut by Income Group - Reduction of Top Rate, Increased Standard Deduction and Retirement Income Exclusion

**Total Tax Cut:  
\$826 million**



**All tax cuts fully phased-in;  
based on 2007 income  
levels. Analysis by Institute  
for Taxation and Economic**

# BUSINESS TAXES

## CORPORATE INCOME TAX

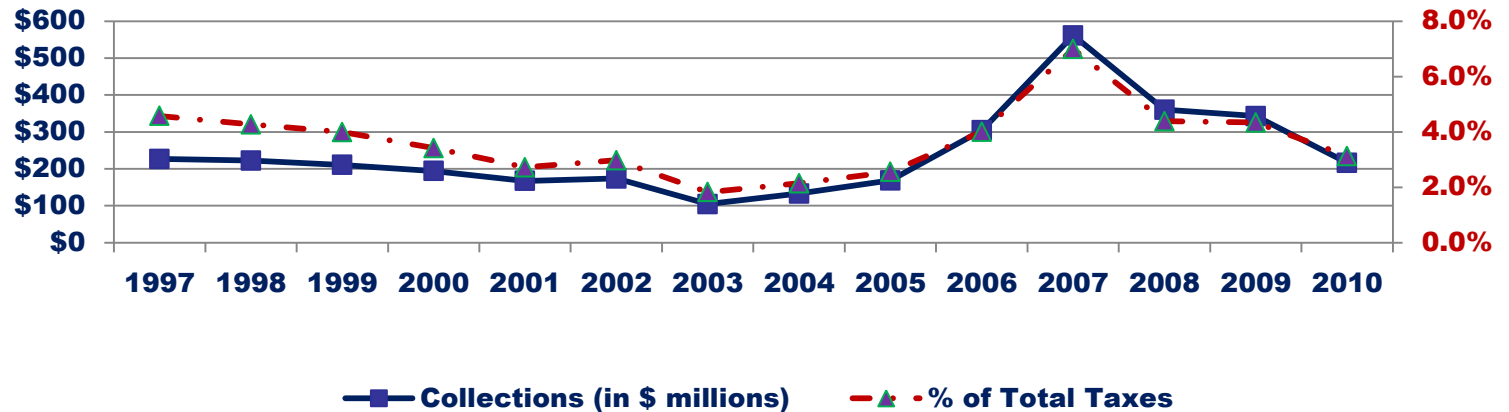
- **Important component of adequate and fair state tax system;**
- **Ensures that large and profitable corporations that benefit from public services pay their share towards maintenance of those services;**
- **Only taxes profitable businesses;**
- **Largely borne by corporate shareholders**
  - **Makes it a progressive tax;**
  - **Partly exported to shareholders in other states.**
- **Helps ensure that individuals don't dodge the personal income tax by incorporating.**

# BUSINESS TAXES

## CORPORATE INCOME TAX

- **Stagnant or declining component of state revenue system:**
  - **Since 1997, under 5 percent of total state taxes every year except FY '07.**

**Corporate Income Tax Collections, FY '97 - FY '10  
Total (in \$ millions) and as % of Total State Taxes**



Source: Data from Annual Executive Budget Book

# BUSINESS TAXES

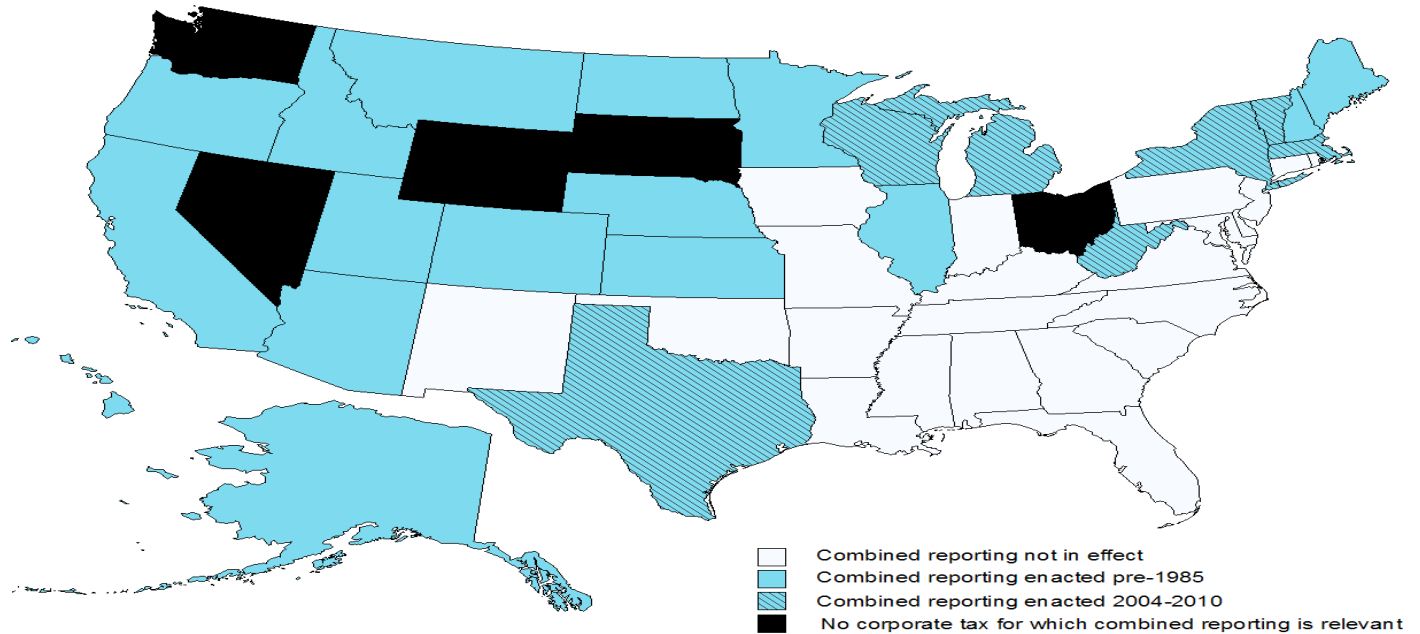
## STRENGTHENING THE CORPORATE INCOME TAX

- Many companies avoid corporate income taxes by exploiting a variety of loopholes, tax shelters and accounting schemes:
  - Prominent examples include Passive Investment Companies, REITs (Real Estate Investment Trusts), transfer pricing.
- Corporate tax avoidance strategies hurt state revenues and small, local businesses that can't easily adopt them;
- *Combined reporting* is a simple, effective method to close loopholes and provide a level playing field for businesses:
  - Treats parent companies and most subsidiaries as one corporation for state income tax purposes;
  - State taxes a share of the combined income of the multi-corporate group.

# BUSINESS TAXES

## STRENGTHENING THE CORPORATE INCOME TAX

- A majority of states with corporate income tax have adopted *combined reporting* (24);
- 7 states have added it since 2004;
- Oklahoma and New Mexico last Western hold-outs.



Source: Center on Budget and Policy Priorities

# BUSINESS TAXES

## **BUSINESS TAXES: THE RIGHT MIX**

- **Along with adopting combined reporting, Oklahoma should retain some form of alternative minimum tax assessed on all businesses;**
  - **Serves as a ‘backstop’ to the corporate income tax;**
  - **Ensures all businesses contribute.**
- **Generally broad-based, low rate assessment calculated on the basis of investment or gross receipts;**
- **Options include:**
  - **Franchise tax;**
  - **Gross Receipts Tax;**
  - **Business Activity Tax (gross receipts tax with some deductions allowed).**
- **New Hampshire assesses a Business Enterprise Tax**
  - **Tax on value-added within a firm and paid only by companies that have little or no corporate income tax liability.**

# ONLINE SALES

## THE CHALLENGE OF TAXING ONLINE SALES

- ***Quill vs. North Dakota (1992):*** Retailers who lack a physical presence ('nexus') in a state cannot be required to collect and remit tax owed to the state;
- **Congress has failed to pass legislation authorizing states to require use tax collections by Internet sellers;**
  - **Streamlined Sales Tax Agreement** intended to encourage voluntary participation;
- **Estimated loss of state and local tax revenue of \$86 million in 2009, \$141 million in 2012;**
- **Puts local bricks-and-mortar retailers at a significant disadvantage to their online competitors;**
- **Adds to regressivity of sales tax:**
  - **Wealthier households likelier to have computers, Internet access.**

# ONLINE SALES

## STATES AND LOCAL BUSINESSES PUSH BACK

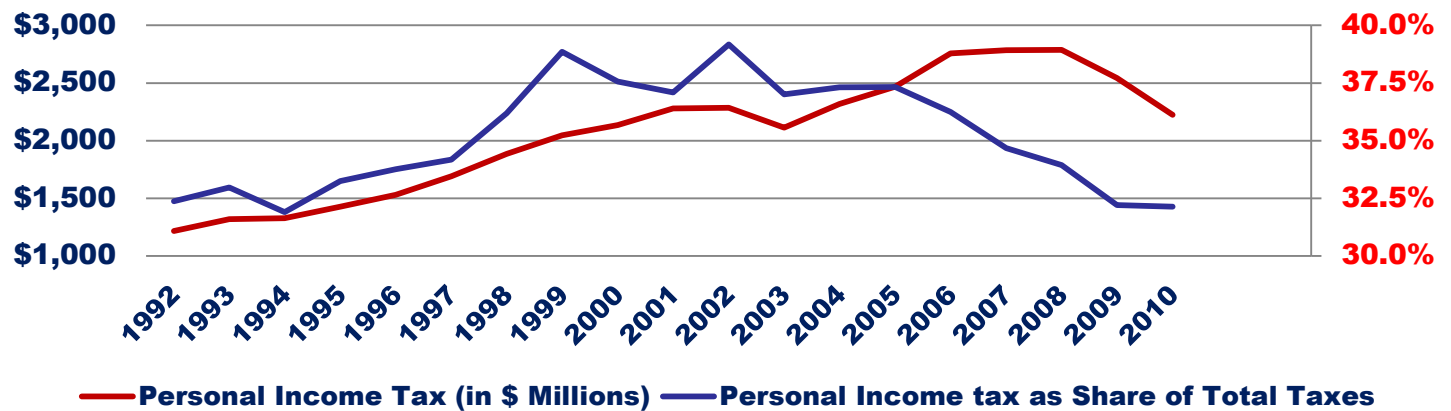
- **Actions Oklahoma has taken:**
  - **Use Tax line on state income tax form;**
  - **Expanded state nexus provision:**
    - **Online retailer should be collecting taxes if it has an in-state affiliate acting on its behalf;**
  - **Online retailer must disclose to customer that they may owe taxes on their purchase;**
  - **Income tax preparers must inform clients they may owe taxes on online purchases.**
- **Some states have gone further:**
  - **Colorado: Requires sellers to provide customers an annual receipt of their purchases and report total annual purchases of their customers to Tax Commission;**
  - **Amazon Laws: Defines ‘affiliate programs’ (click-thru link to retailer’s website) as establishing nexus:**
    - **New York, Arkansas, California, Connecticut, Illinois, North Carolina, Rhode Island, Vermont.**

# PERSONAL INCOME TAX

## INCOME TAX: VITAL FOR AN ADEQUATE TAX SYSTEM

- Personal income tax is single largest source of state tax collections;
- Share of state taxes declining since FY '05 due to tax cuts and recession, now <1/3<sup>rd</sup>;
- Total collections flat 2006-08, then fell sharply.

**Personal Income Tax Collections, Total and as Share of Total Tax Collections, FY '92 - FY '11**



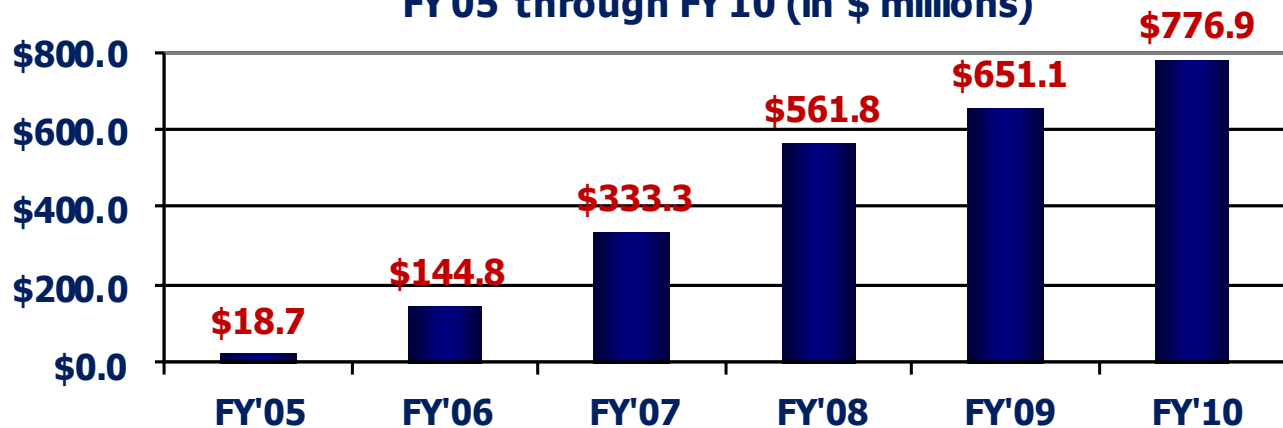
Source: Data based on Annual Executive Budget Book

# PERSONAL INCOME TAX

## INCOME TAX: VITAL FOR AN ADEQUATE TAX SYSTEM

- Major tax cuts 2004-2006
  - Top income tax rate lowered from 6.65 to 5.25 percent;
  - Standard deduction raised and indexed to federal level;
  - Increased exemptions of retirement income;
  - Exclusion of Oklahoma-based capital gains;
  - Phased-out repeal of Oklahoma estate tax.

Lost Revenues from Select Tax Cuts Enacted 2004 - 2006  
FY'05 through FY'10 (in \$ millions)



Source: Oklahoma Tax Commission revenue estimates

# PERSONAL INCOME TAX

## INCOME TAX: VITAL FOR AN ADEQUATE TAX SYSTEM

### Replacing the Income Tax: The 'Texas Plan'

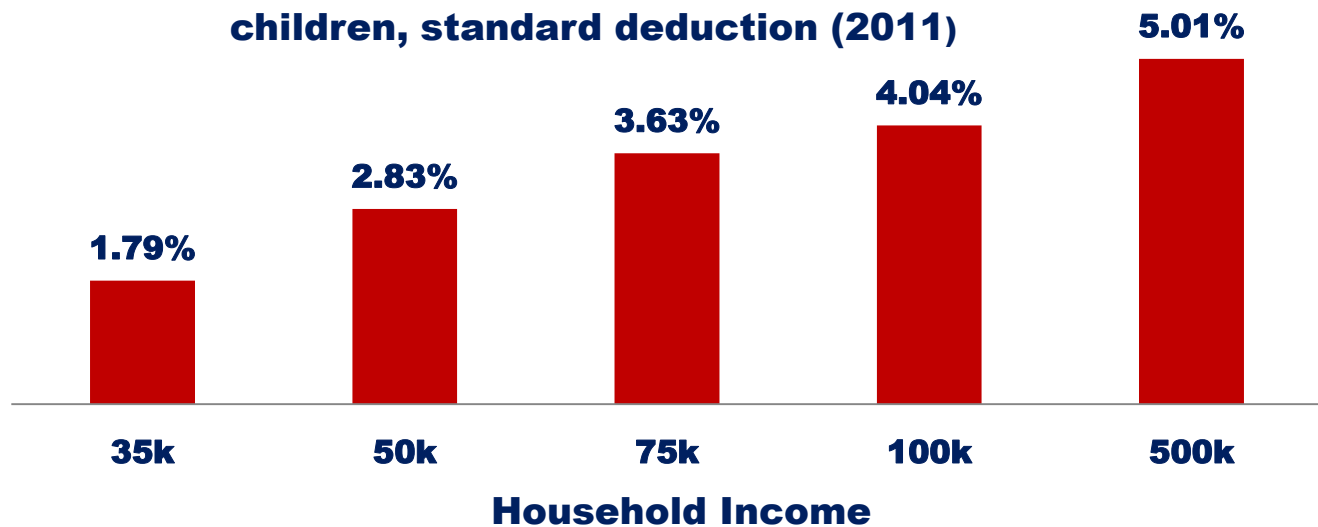
- **To achieve revenue-neutral tax reform while abolishing the income tax, prominent economists in 2001 considered:**
  1. raising property taxes;
  2. expanding the sales tax base to services and increasing the sales tax rate; or
  3. enacting a gross receipts tax.
- **None of these options would be revenue-neutral over time;**
- **Did not consider exclusive reliance on increased sales tax rate**
  - **“As Oklahoma already has a relatively high combined state and local sales tax rate (7.5 – 8.0 percent), the levy of such an increase may be questionable”**
- **Governor Keating initially proposed a 5.9 percent gross receipts tax on a broad base of goods and services as substitute for income tax and sales tax on groceries.**

# PERSONAL INCOME TAX

## INCOME TAX: VITAL FOR A FAIR TAX SYSTEM

- Personal income tax is based on ability to pay, offsetting some of the regressivity of sales and excise taxes;
- Low- and moderate-income Oklahomans are taxed at a lower rate than upper-income Oklahomans.

Effective Tax Rates for married joint filers with two children, standard deduction (2011)



# PERSONAL INCOME TAX

## INCOME TAX: VITAL FOR A BALANCED SYSTEM

- Prevents over-reliance on any single revenue stream;
- Income tax is most dynamic tax source;
- Non-income tax states face even worse immediate challenges and structural deficits.



# PERSONAL INCOME TAX

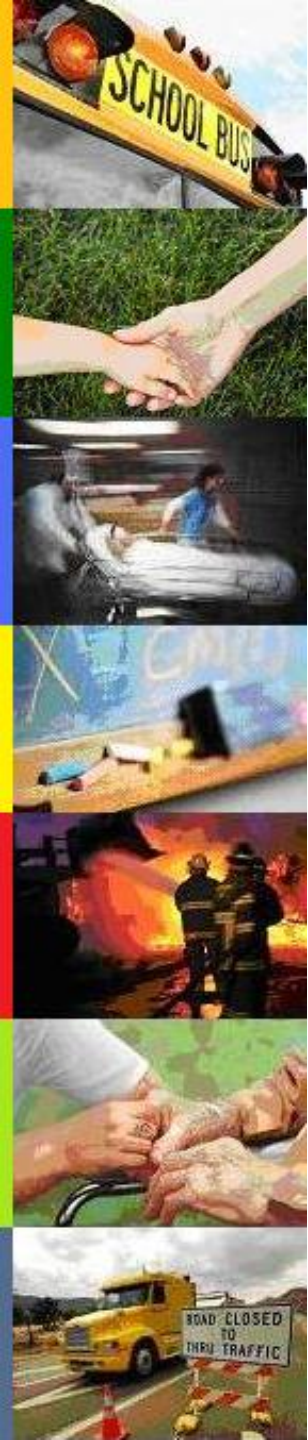
## SLASHING THE INCOME TAX IS NOT THE RIGHT PATH FOR ECONOMIC GROWTH

- Extensive economic development literature establishes that investment decisions are driven more by the presence of a well-trained, productive workforce and strong public infrastructure than by state and local tax rates.
- Review by Dr. Robert Lynch of hundreds of economic and econometric studies found:
  - "state and local taxes, at their current low levels, may be largely irrelevant to business investment decisions."
  - "any jobs that might be gained by cutting taxes can be more than offset by the jobs lost as a result of cuts in public services."

### Rank of Relevant Factors in Location Decisions

<b>1</b>	<b>Labor Productivity</b>
<b>2</b>	<b>Skilled Labor Supply</b>
<b>3</b>	<b>Labor Costs</b>
<b>4</b>	<b>Distance to Major Market/Access</b>
<b>5</b>	<b>Crime Rates/Safety</b>
<b>6</b>	<b>Highway Access</b>
<b>7</b>	<b>Quality Health Care Facilities</b>
<b>8</b>	<b>Red Tape – Regulatory Climate</b>
<b>9</b>	<b>Public Schools</b>
<b>10</b>	<b>Corporate Tax Rate</b>

Source: Louisiana Business Image Survey



# TAX REFORM: FIVE IDEAS

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## 1. LIMIT TAX INCENTIVES

- **Tax credits should adhere to the following standards:**
  - **Formal eligibility process for businesses applying for credits;**
  - **Clear performance standards regarding investment and/or job creation, and consequences for failing to meet targets;**
  - **Full disclosure of how credits are allocated;**
  - **Sunset provisions, with reauthorization tied to a ‘performance review’;**
  - **Limit state liability through caps on amounts that can be claimed – subject to annual legislative authority.**

# TAX REFORM: FIVE IDEAS

## 2. LIMIT ITEMIZED INCOME TAX DEDUCTIONS

- **Mostly benefits upper-income households;**
- **Several options could be considered:**
  - **Repeal itemized deductions while increasing the standard deduction available to all families, OR**
  - **Cap the total value of itemized deductions, OR**
  - **Convert deductions to a credit as a set amount of select federal deductions, OR**
  - **Do away with the deduction for state income tax payments**
- **Could generate \$100 - \$115 million in additional revenue;**
- **Federal deductions means that additional state tax liability would be partly offset by reduced federal tax liability.**

# TAX REFORM: FIVE IDEAS

## 3. STRENGTHEN THE SALES TAX

- **Expand the sales tax base to cover selected services**
  - **Oklahoma currently taxes only 32 of 168 potentially taxable services;**
  - **Taxing services is needed to maintain the long-term adequacy of the sales tax and make the sales tax more economically fair and rational;**
  - **Should be careful to exclude services consumed primarily by businesses to avoid pyramiding.**
- **Do away with sales tax exemptions benefitting favored industries;**
- **Pursue collection of online sales through ‘click-through’/affiliate programs;**
- **Consider combining these measures with lifting the sales tax on groceries.**

# TAX REFORM: FIVE IDEAS

## 4. ALLOW HIGHER TAXES ON COMMERCIAL PROPERTY

- **Assessment ratio on all real property limited to 11 - 13.5 percent (except for public service corporations);**
- **All real property limited to 5 percent annual increase in valuations (potentially 3 percent for homestead properties subject to voter approval in 2012);**
- **Businesses in Oklahoma are paying extremely low rates compared to other states:**
  - **Most states classify property based on its use and apply different assessment ratios to different classes of property (e.g. residential, agricultural, commercial, industrial);**
    - **e.g. Kansas: Residential property 11.5 percent, commercial property 25 percent;**
  - **Few states cap taxable values on income-generating property.**

# TAX REFORM: FIVE IDEAS

## 5. PROVIDE BROAD-BASED INCOME TAX CUTS

- If tax cuts are on the table, increasing the personal exemption and stretching income tax brackets would *assist more households* and *distribute benefits more broadly* than a further cut to the top rate :
  - Personal exemption has remained unchanged at \$1,000 per person since 1982;
  - Failure for decades to index income tax brackets:
    - Seven brackets all narrowly squeezed together;
    - Top bracket (5.25 percent) at \$8,701 of taxable income for single taxpayers and \$15,501 for married couples/heads of household;
    - *Bracket creep* : 56 percent of taxpayers now reach the top bracket, much greater share of income taxed at highest level.

# Guiding Principles

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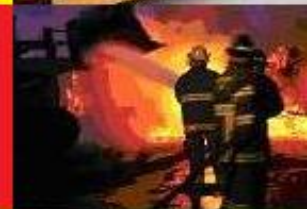
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**“Taxes, after all, are dues that we pay for the privileges of membership in an organized society”**

**~ Franklin D. Roosevelt**

**“People want just taxes more than they want lower taxes. They want to know that every man is paying his proportionate share according to his wealth.”**

**~ Will Rogers**



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