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Strategies for Economic Growth and Tax Reform:
Tax Reform in Other States

Special Council on Tax Reform and Fairness for Georgians

Preparation for August 25, 2010 Meeting

Competition continues to intensify amongst states, regions and countries attempting to attract the companies and high-income individuals and smaller, growing companies that provide a community with employment and higher standard of living. This competition creates a complex, challenging and dynamic environment. The most intense competition frequently comes from neighboring states.

The attached documents are selected for your review because they are representative of the two basic alternatives or philosophies for 'growth and tax 'strategies. By considering past experience as well as the current strategies of other states, we will be in a better position to fashion our tax reform consistent with a competitive growth strategy for Georgia.

Materials for Preview:

1. Schematic on Tax Structure and Economic Efficiency

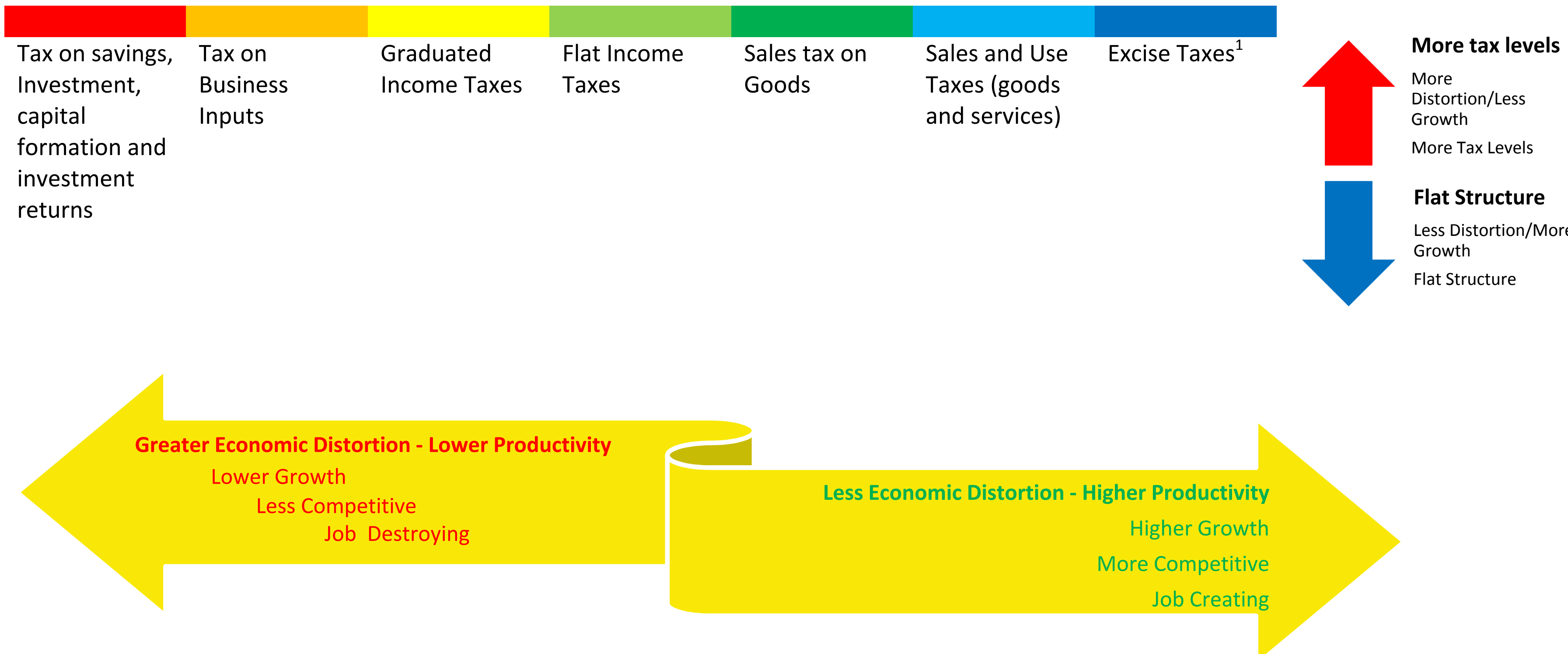
2. "Oregon Referendum Could Reinstate Higher Income Tax Rates," by Joseph Henchman and Kail Padgitt, The Tax Foundation, Fiscal Fact No. 206 *(www.taxfoundation.org)*

3. "The Gates of Confiscation," The Wall Street Journal, August 14, 2010 (www.wsj.com)

4. "Rhode Island Officials Consider Income Tax Reform," *By Joseph Henchman and Kail Padgitt, The Tax Foundation, Fiscal Fact, No. 232 (www.taxfoundation.org)*

5. "New Mexico Provides Model for Georgia Tax Reform," By Mark King, Georgia Public Policy Foundation (www.GPPF.org)

Tax Structure and Economic Growth



[1] Common excise taxes are cigarettes and alcohol. Increasingly some states are imposing excise taxes on sugary drinks such as soft drinks. Justification is that use of these products imposes costs on the community – not just the user. For example, in case of cigarettes, economic justification is to tax for revenue to cover the expense of higher medical costs borne by state for smokers.

Prof. Christine P. Ries August 2010

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Commentary

New Mexico Provides Model for Georgia Tax Reform

By Mark King

When it comes to the tax climate, Georgia ranks middle of the road or worse in several categories, according to the Tax Foundation. The state ranks 29th (50 being the worst) in the State Business Tax Climate Index, a judge of the state tax structure's promotion of economic growth, and has the 23rd highest top income tax rate at 6 percent. The middle of the road is better than the ditch, but why not strive for the fast lane?

When Georgia is compared with neighboring states, the urgency of tax reform is evident. Tennessee and Florida have no taxes on wages; Georgia taxes 6 percent of income. Georgia ranks worst among its border states in state and local tax burden according to the Tax Foundation. Clearly, it's time to do a better job of encouraging economic growth through tax reform.

For a shining example of tax reform, "Go West" to New Mexico. In 2003, Governor Bill Richardson signed into law a set of income tax reductions. The legislation lowered the top income tax rate from 8.2 percent to 4.9 percent by 2008. Despite dire predictions that the state would lose revenue, during the years of this tax reduction revenues increased and New Mexico experienced a period of substantial economic growth.

The simple explanation could be that the increases in New Mexico's tax revenue reflect the economic boom of the mid-2000s. Yet, when compared with Georgia's economic growth over the same time period, New Mexico shows far superior growth.

Georgia's top income tax remained constant at 6 percent from 2003 to 2008 while New Mexico's top income tax dropped 3.3 percentage points. Analysis of the personal income per capita and gross domestic product (GDP) per capita growth in both states shows that New Mexico experienced significantly higher rates of economic growth.

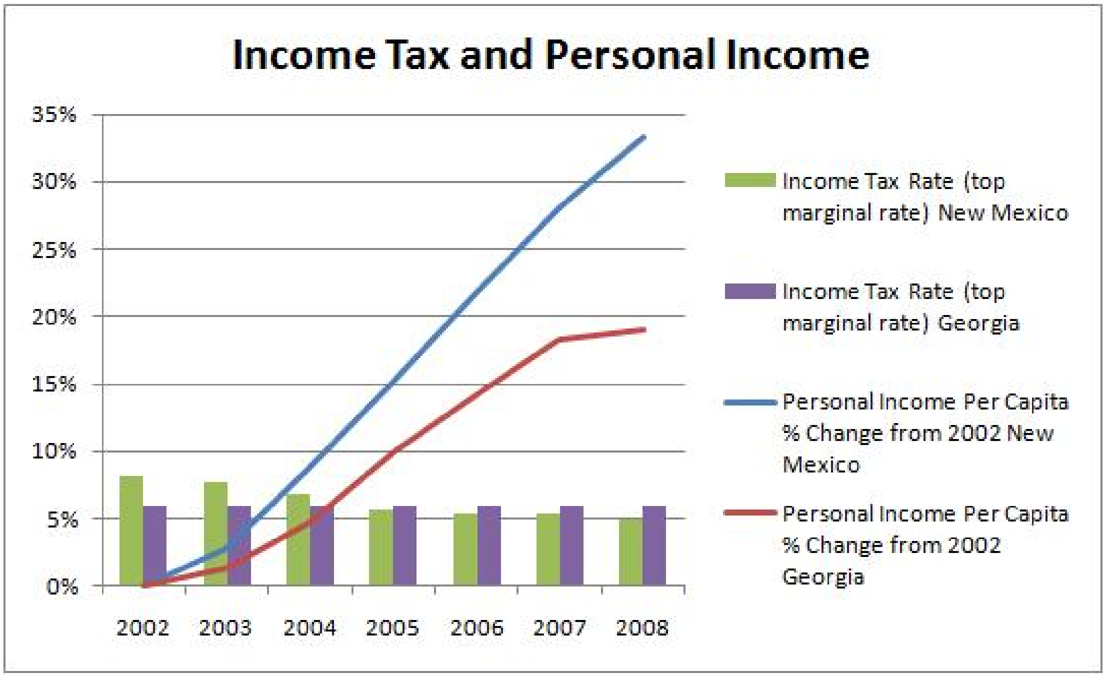
Personal income per capita in New Mexico grew 33 percent, from $25,049 in 2002 to $33,385 in 2008. Georgia's personal income increased just 19 percent, from $29,264 to $34,849. GDP expansion shows an even more dramatic difference: From 2002 to 2008, GDP per capita grew a whopping 42 percent in New Mexico compared with just 15 percent in Georgia. New Mexico had a lower starting point with both metrics, but has nearly surpassed Georgia with no sign of slowing down.

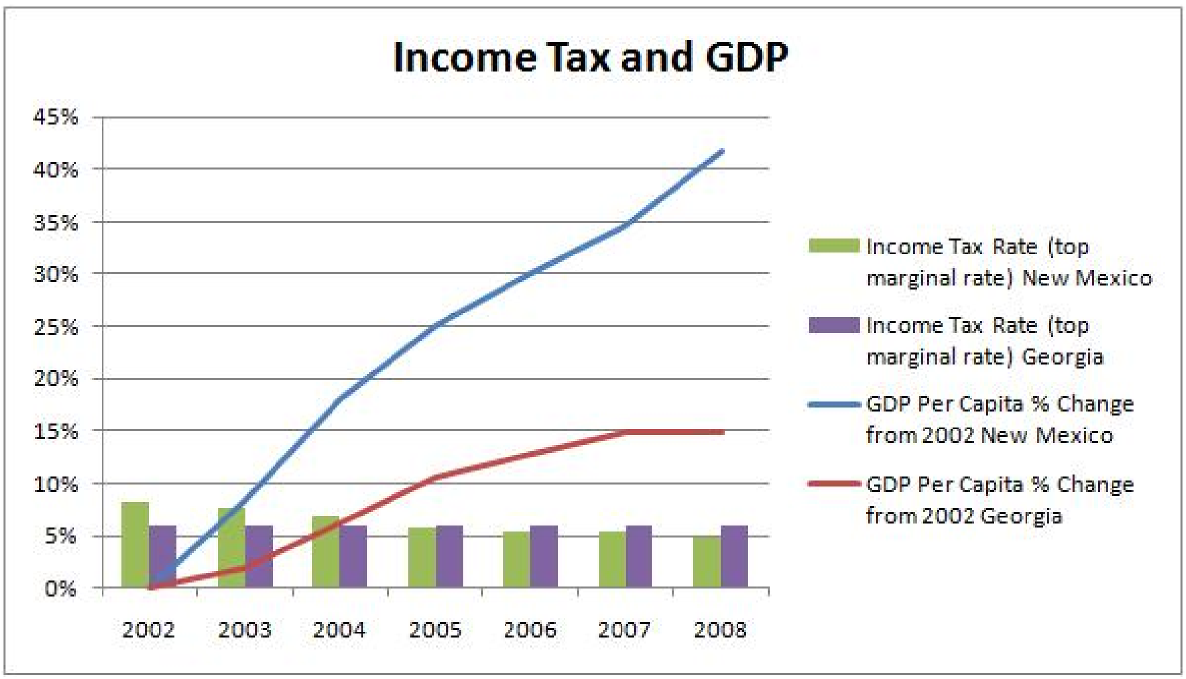
The Rio Grande Foundation, a free-market policy group in New Mexico, recently proposed phasing out the income tax all together in order to compete with the likes of Wyoming, Nevada and Texas, all zero income tax states. According to a study by the group, a 4.5 percent cap on annual spending growth would enable the state to eliminate the income tax within five years.

Because of the recent recession plans of this nature have most likely been placed on the back burner. Nevertheless, New Mexico has situated itself to better weather the storm by fostering economic growth over the past six years. Economic growth means more jobs, the central need for its citizens in hard times. The remarkable increase in personal income per capita is compelling evidence for lowering income taxes to improve the standard of living. Simply put, people want jobs, and when they have a job they want to increase their income.

To put things in perspective, had Georgia enjoyed the economic growth of New Mexico over the past six years, personal income per capita would be more than $4,000 greater than the current level. Certainly, many Georgians could desperately use that difference in income. Too, more people would begin to understand the economics in not taxing income, investment and production.

A more viable solution is to focus more on taxing consumption. Consumption taxes incentivize saving, investment and fiscal responsibility. Broadening the tax base would also help reduce volatility in tax revenue. Tough times call for tough decisions. Tax reform is not an easy Sunday drive, it's a hard fought and, hopefully, well thought out process. Georgia's current income tax structure hinders kinds of gains enjoyed by New Mexico and its proactive policies. Now, especially, is a time to change gears and drive economic growth across the state.





Mark King, who is completing his master's degree at the University of Georgia, is a summer intern with the Georgia Public Policy Foundation. The Foundation is an independent think tank that proposes practical, market-oriented approaches to public policy to improve the lives of Georgians. Nothing written here is to be construed as necessarily reflecting the views of the Foundation or the Center for Health Transformation or as an attempt to aid or hinder the passage of any bill before the U.S. Congress or the Georgia Legislature.

TAX FOUNDATION Since 1937

FISCAL FACT

June 2, 2010
No. 232

Rhode Island Officials Consider Income Tax Reform

By Joseph Henchman and Kail Padgitt

Rhode Island officials are taking steps that may result in a tax reform effort with positive implications.

The Challenge

The Ocean State currently suffers from a 12.5% unemployment rate, higher than every state except California, Nevada, and Michigan. The state is the tenth-highest in state-local tax burden, has the seventh-highest state-local property tax collections, and has the fifth-highest state-local debt per capita. The 9.9% top individual income tax rate is among the highest in the country, as is the 9% corporate income tax rate, and the 7% sales tax is high as well. The cigarette tax is also the highest in the country. The state puts heavy reliance on the usual corporate giveaways through the tax code (job credits, research-and-development credits, investment credits, film credits, etc.). These programs are generally more about photo-ops and handouts to the politically connected than broad-based economic development.

Our 2010 *State Business Tax Climate Index* ranked Rhode Island 44th in the country in favorable business tax climate, comparing unfavorably with its immediate neighbors:

Table 1
Rhode Island and Its Neighbors' Business Tax Climate Ranks

State	2010 *Index* Overall Rank
Rhode Island	44
Connecticut	38
Massachusetts	36

Source: Tax Foundation *2010 State Business Tax Climate Index*

Joseph Henchman Is Tax Counsel and Director of State Projects at the Tax Foundation and Kail Padgitt Is Staff Economist.

As we put it last year, Rhode Island faces a tough tax situation because it has significantly lower per-capita income than its two neighbors, and therefore must impose higher taxes to raise revenues in line with its neighbors. Unfortunately, those high tax rates add further incentive for wealthy people and businesses to leave Rhode Island for its lower-tax neighbors, or for other parts of the country.

Consensus for Change: Optional Flat Tax and Carcieri 2009 Proposal

Consequently, a consensus has developed among Rhode Island policymakers that the state's tax system is a hindrance to long-term economic growth. In 2006, officials began phasing in an optional flat tax, whereby taxpayers could eschew the 9.9% rate coupled with myriad credits and deductions, and instead pay one rate on all their income. The rate began at 7% and has been stepping down each year. In 2009, the optional flat tax rate stood at 6.5%; in 2010, it is 6%; and in 2011 it will reach 5.5% where it will stay.

If the 5.5% optional flat tax was in place in 2010, Rhode Island would rank 43rd in the *State Business Tax Climate Index* instead of 44th.

The optional flat tax has been the key driver to the state's modest improvement in the *State Business Tax Climate Index*, from dead last (50th) in 2006 to 44th in 2010. (Note: We give a state credit only for tax changes that are in effect as of our annual snapshot date, and not for legislated changes that have not yet taken effect. Sometimes legislated tax reductions are postponed or cancelled, as happened in Ohio this year.)

Last year, Rhode Island Gov. Don Carcieri (R) proposed a plan to phase out the state's corporate income tax over four years, joining four other states without a major business tax. The plan also eliminated many deductions and credits and reduced the top individual income tax rate to 5.5%. Carcieri also proposed to raise the cigarette tax still further, by $1 to $3.46 per pack, the only part of the proposal that was enacted.

The 2009 Carcieri plan was ambitious but would have given Rhode Island a chance to step out from its neighbors' shadows and specialize in attracting capital, business activity, and economic growth. Last year we estimated that had the Carcieri plan been enacted in 2009, the state would have moved from 46th to 16th in the nation in our *State Business Tax Climate Index*.

Current Proposal

In late May 2010, Rhode Island legislative leaders began outlining a tax reform proposal. As we understand it at press time, the plan would incorporate these elements:

- Replace the state's current individual income tax structure with three brackets, with a top rate of 6%.
- Raise the amounts of the lump-sum standard deduction that most taxpayers claim, but eliminate the option to make a detailed list of deductions - a process known as itemizing.
- Allow only a handful of tax credits, including one for taxes paid to other states, the earned-income tax credit, the statewide property-tax relief credit and a credit for residential lead-paint abatement. Tax credits for investment, research-and-development, and job creation would be repealed but the film tax credit would remain.
- The optional flat-tax method of calculating one's Rhode Island income tax would be eliminated.

Minor differences between House and Senate versions remain to be worked out, but if the outline of the proposal were in place in 2010, Rhode Island would rank 41st in the *State Business Tax Climate Index* instead of 44th. This indicates the plan would be a modest but positive change for the state's tax system.

Table 2
Rhode Island and Its Neighbors' Business Tax Climate Ranks With Changes

State	2010 *Index* Overall Rank	2010 *Index* Overall Rank with Fully Phased-In Flat Tax	2010 *Index* Overall Rank with May 2010 Tax Proposal
Rhode Island	44	43	41
Connecticut	38	38	38
Massachusetts	36	36	36

Source: Tax Foundation.

Conclusion
Rhode Island has shown its willingness to tackle its problematic tax system. Tax pundits were surprised when the state became a flat-tax pioneer, and the broad consensus for improvement means that this may be the Ocean State's moment. Rhode Island can compete with its border states and beyond, and it has recently shown the political will to do so. As the economy improves, capital and investment will flow to those states best positioned for it. Rhode Island has a chance to welcome that opportunity, and frankly, the state has nowhere to go but up.

The state should not get rid of the optional flat tax lightly but the proposal under discussion is an improvement, albeit a modest one. Tackling the state's high corporate income tax rate, particularly as they eliminate credits and deductions used by many businesses, may be politically essential. But the plan echoes the advice of tax experts everywhere: broad bases and low rates.

Note: After press time, we were informed that legislative leaders may only eliminate tax credits and deductions in the individual income tax code. Our report assumes the elimination of tax credits and deduction in both the individual and corporate tax codes.

January 7, 2010

Oregon Referendum Could Reinstate Higher Income Tax Rates

by Joseph Henchman and Kail Padgitt

Fiscal Fact No. 206

Introduction

On January 26, 2010, Oregon residents will decide whether to approve or reject some of the state's tax increases passed in 2009. Measure 66 will enact two new individual income tax brackets (with rates at 10.8 percent and 11 percent), and Measure 67 will increase corporate income taxes.

If Measure 66 passes, the new 11 percent state income tax rate will combine with local income taxes to give high-income Oregonians the highest state tax bill in the nation. Hawaii is the only other state with an 11 percent rate on the books, but there are no local income taxes there. The new, higher rates would go into effect retroactively to January 1, 2009; if the measure fails, the individual income tax increase is cancelled. Similarly, if Measure 67 passes, the corporate income tax increase will go into effect retroactively to January 1, 2009; if it fails, the corporate income tax increase is cancelled.

This report reviews how the results of the January 26 referendum would affect Oregon's *State Business Tax Climate Index* ranking.

Tax Increases Dropped Oregon Out of Top Ten on Ranking of Most Business-Friendly States

One of the major stories from our *State Business Tax Climate Index* this year was the fall of Oregon out of the top ten due to the tax increases in H.B. 2649. Oregon had consistently scored as one of the ten most business-friendly states in terms of tax climate, but the enactment of the tax increases led to its drop from 8th place in FY 2009 to 14th place in 2010.

Prior to the increases, Oregon's individual income tax consisted of three brackets: 5 percent on taxable income between $0 and $3,050; 7 percent between $3,050 and $7,600; and 9 percent over $7,600 (see Table 1). Under the new structure, two additional tax rates on higher income brackets are tacked on for 2009-11: 10.8 percent for income between $125,000 and $250,000, and 11 percent on income over $250,000. In 2012, the top bracket is removed and a 9.9 percent rate is imposed on all income over $125,000. Oregon's budget office estimates that these tax increases will raise $472 million for the 2009-11 fiscal biennium.

Table 1
Oregon's Personal Income Tax Rates and Brackets
if Referendum Reinstates Tax Increases

Before Legislation	2009-2011	After 2011

Rate	Bracket	Rate	Bracket †	Rate	Bracket †
5%	> $0	5%	> $0	5%	> $0
7%	> $3,050	7%	> $3,050	7%	> $3,050
9%	> $7,600	9%	> $7,600	9%	> $7,600
		10.8%	> $125,000	9.9%	> $125,000
		11%	> $250,000		

† All bracket amounts shown are for singles. Brackets are doubled for couples filing a joint tax return. The lowest three brackets are adjusted for inflation each year. The new top brackets, however, will not be adjusted, forcing more people into these brackets each year due to inflation alone.

Source: Tax Foundation

On the corporate side, the state scrapped the 6.6 percent flat rate on corporate income in favor of a bracketed system and a new top rate of 7.9 percent (dropping to 7.6 percent after 2011). The minimum corporate income tax also rose from a nominal $10 to a sliding scale based on gross sales, ranging from $150 for corporations with less than $500,000 in annual sales to a $100,000 minimum tax bill for corporations selling more than $100 million. (Many corporations have losses this year, leading to them paying only the minimum tax.)

Effect of Referendum on Applicability of Tax Increases

Although the legislature passed the tax changes and Oregon Governor Ted Kulongoski signed them into law in July, opponents launched an effort to gather the 55,179 signatures needed to refer the increases to the ballot as a "veto referendum." They were successful and in early October, the Secretary of State certified the two measures for the ballot. Under Article IV, Section 1, of the Oregon Constitution and subsequent cases interpreting it, the tax increase measures are suspended until the referendum occurs.[1]

Consequently, while the tax increases were technically in effect from July to October, they are not now in effect. If the measures pass, it will be as if the taxes were in effect retroactive to January 1, 2009; if the measures fail, it will be as if the taxes were never enacted. Consequently, the Department of Revenue has requested that Oregon taxpayers not file their 2009 tax returns due in 2010 until after the referendum has either validated or invalidated the new tax rates.

The legislature did pass some tax increases that were not referred to the ballot, including increases to gasoline, vehicle registration, health care and tobacco taxes. These have not been suspended, and they will not be affected by the referendum.

Impact on the *State Business Tax Climate Index*

There are four possible outcomes from the special election:

- Both tax increases are enacted;

- The individual income tax is rejected but the corporate income tax is enacted;
- The individual income tax is enacted but the corporate income tax is rejected;
- Both tax increases are rejected.

The table below illustrates how Oregon would have ranked in the *State Business Tax Climate Index* this year under each scenario:

Table 2
Oregon's *State Business Tax Climate Index* Rankings under Different Referendum Outcomes

Referendum Outcome	Ranking
1. Both tax increases are enacted	14th
2. The individual income tax is rejected but the corporate income tax is enacted	9th
3. The individual income tax is enacted but the corporate income tax is rejected	13th
4. Both tax increases are rejected	8th

Rankings are out of 50 states. The higher the rank, the more business friendly the tax climate.

Source: Tax Foundation

For Option 1, if both tax increases are upheld then the rankings will not change. This simply means that the original *Index* score and ranking (14th best) will stand.

For Option 2, if the individual income tax hikes are repealed but the corporate income tax increases are upheld, then the ranking would improve from 13th to 9th. This is a substantial gain overall, caused by the move from 45th best to 32nd best on the sub-index devoted to measuring each state's personal income tax.

For Option 3, if the corporate tax increases are repealed but the individual income tax increases are upheld, then the ranking improves one spot to 13th, reflecting an improvement from 31st to 25th in the sub-index devoted to comparing the 50 states' primary business taxes.

For Option 4, if both the increases to individual income and corporate income tax are repealed, then Oregon will return to the top-ten ranking it maintained before the tax hikes of 2009. That is, it would be ranked as having the 8th best tax climate in the nation, this despite the passage of additional taxes on gasoline, vehicle registration, health care and tobacco.

Conclusion

Oregon legislators approved more than $1 billion in tax increases for the 2009-11 fiscal period, not only to balance the budget but to expand it as well. In doing so, there was an effort to dump the majority of its new tax burden onto a small group of high-income Oregonians. If these individuals move out of state or choose to work less, both the state budget and the state economy will suffer.

Oregonians have in the past shown their willingness to strike down tax increases on statewide ballots, but many supporters of these new tax measures claim that a recent leftward shift in Oregon's political landscape may preserve the legislature's tax increases. With most states confronting budget situations similar to Oregon's, observers nationwide will be carefully watching the results on January 26.

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[1] *See, e.g.*, *Bernstein Bros. v. Dep't. of Revenue*, 661 P.2d 537, 540 (Or. 1983) ("We conclude that the power itself was created to benefit the majority of the people by suspending operation of a statute until the people have an opportunity to approve or reject legislation.")

Attached Files

- Fiscal Fact No. 206: Oregon Referendum Could Reinstate Higher Income Tax Rates, *PDF, 27.7 KB*
  by Joseph Henchman and Kail Padgitt

THE WALL STREET JOURNAL.
WSJ.com

TAXES | JANUARY 27, 2010, 6:58 P.M. ET

Oregon Passes Tax Boost on Wealthy, Corporations

By JOEL MILLMAN

PORTLAND, Ore.—Oregon voters approved two special tax measures Tuesday designed to close a $733 million state budget gap. With 91% of the vote counted, Measure 66 garnered 54% of ballots and Measure 67 received 53%, the Associated Press reported.

Elections here are by mailed ballot only. Tuesday was the last day ballots could be cast.

Measure 66 increases Oregon's personal-income-tax rate by two percentage points for households earning over $250,000 a year. Measure 67 calls for an increase in the state's minimum corporate income tax, currently $10 a year, and imposes a tax on gross revenues for corporations that don't report a profit.

The Oregon Legislature approved both tax increases last year, however opponents of the measures—chiefly business groups—sponsored a referendum campaign to put them to a statewide vote. Voters in this heavily Democratic state supported the legislators.

"Passage of these measures means we keep core services of education, health care and public safety that Oregon families, businesses, and communities count on," said Oregon House Speaker Dave Hunt, a Democrat who represents Clackamas County. Defeat, he said, would have forced the state to cut nearly a billion dollars more from such services.

The twin ballot measures also served as a gauge of anti-business populism and highlighted a nationwide debate over whether to fix state budgets by targeting the affluent. But they also fueled resentment of "tax and spend" legislators, as well as public-employee unions whose members enjoy job security at a time when thousands here have lost jobs.

By targeting out-of-state corporations in campaigning for the new taxes, proponents of the measures persuaded many voters that much of the new funding needed to close the state's budget gap would be borne by outsiders. Opponents disagreed with that analysis, arguing that only 3% of the targeted revenue would come from corporations with headquarters outside Oregon.

Kevin Looper, campaign dIrector for the organization Vote Yes for Oregon was jubilant. "It's an incredible victory for some very courageous political leaders, who in the middle of a recession decided to protect schools and vital services," he said.

"Oregon voters said 'no' to more 4-day school weeks and bulging class sizes and 'yes' to corporations and the wealthy paying their fair share," added Gail Rasmussen, president of the Oregon Education Association, one of the public-sector unions that campaigned hard for Measure 66 and 67's passage. "Tonight's results are a credit to the hard work of parents, educators, and thousands of Oregonians from every walk of life who stood up to protect our schools."

Write to Joel Millman at joel.millman@wsj.com

THE WALL STREET JOURNAL.
WSJ.com

REVIEW & OUTLOOK | AUGUST 14, 2010

The Gates of Confiscation

Look who wants to give Washington state an income tax.

The battle between taxpayers and government unions will define the fiscal future of the 50 states, and the newest battlefield is Washington state. That's where a few rich taxpayers led by Bill Gates Sr. and the Service Employees International Union (SEIU) are bankrolling a November ballot measure to create the state's first income tax.

And not just a toe-in-the-water tax. They're diving into the deep end with a proposal that would immediately impose a 5% tax rate on income above $200,000, or $400,000 for married couples. The rate would climb to 9% on single filers making $500,000, or $1 million for couples.

No state has introduced an income tax since Connecticut nearly 20 years ago, and that state's experience has not been happy. The top rate in Hartford began at 4.5% but has since climbed to 6.5%. Washington wants to leap over that and achieve California and New Jersey heights in one giant step. Washington would move overnight from one of the nine states with no income tax to having the eighth highest rate in the country.


View Full Image

Associated Press

Bill Gates Sr.

Mr. Gates, a wealthy lawyer whose son is among the richest men on the planet, is pitching the proposal as a chance for 97% of the voters to pay the state's bills by socking it to the richest 3%. What he doesn't say is that Washington's lack of an income tax is among its main comparative advantages in luring those top 3%, along with their businesses and jobs, into the state.

In addition to Washington, the states without an income tax are Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas and Wyoming. Combined they had an average 18.2% growth rate in jobs over the past decade, more than twice the 8.4% job growth of the nine states with the highest income tax rates, according to a new report based on Commerce Department data by the American Legislative Exchange Council.

The liberal Seattle Times accurately describes the state's zero income tax as "a selling point. An asset. And more than that: It's a bonus for living here." Even liberal Democratic Governor Christine Gregoire begins her sales pitch to prospective business investors with the reminder: "No income tax."

That's an especially powerful attraction on the West Coast, where California and Oregon impose a top tax rate of 10.55% and 11%, respectively. Proponents say Oregon raised its income tax last year, so Washington should get in the game. But Oregon at least has no state sales tax. Washington has close to the highest sales tax burden in the nation, varying by area but reaching as high as 10% in Seattle depending on what you buy.

To win votes, the ballot measure resorts to all sorts of trickery. Unions describe the initiative as tax "relief" because it includes a mandatory cut in the hated property tax (only by 4%) and it eliminates various unpopular fees and taxes on business. Still, the overall impact of the measure is a $1.5 billion tax increase in 2012 and $2.5 billion a year by 2016. Small business taxes are cut, but they are also hit with a whopper of a new tax: a personal income tax paid out of their profits. Over half of the tax will be paid by Washington businesses.

The biggest deception is the description of the new income tax as "an excise tax on income." This language is cleverly designed to dodge the state's constitutional prohibition against an income tax and the requirement that any tax be "uniform upon the same property." Obviously a tax that hits only 3% of taxpayers and applies graduated rates is anything but uniform. Proponents claim that because the tax is withheld from worker paychecks, the money was never the property of the person who earned it. That's like saying if someone steals your paycheck, it's not your property.

We hope Washington voters aren't duped by the claim that only the rich will pay this tax. After two years, the law allows the legislature by simple majority to extend the tax to nearly everyone. The revenue from the tax will finance new spending, which will soar and lead to even higher deficits in the next downturn, which will create political pressure to expand the tax to the middle class.

Income taxes are always sold as a one-time way to reduce deficits, but they always become engines of greater spending, and eventually deficits. Just ask Californians. If Mr. Gates wants the rich to finance more Washington spending to create more SEIU dues-paying jobs, he and his son can do so by donating their own fortunes.