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State Tax Reform Efforts: 2010–2015

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Introduction

State tax reform is often on the agenda for policymakers. The period of the Great Recession is no exception to that fact. Perhaps because of the fiscal stress induced by the financial turmoil, several states convened tax reform commissions or similar bodies to comprehensively review the tax codes. This paper documents the comprehensive tax reform efforts of selected states since 2010 to 2015 in an attempt to discover what changes have been contemplated, which actually passed, and potential lessons from state tax reform during this period. This article is a follow up of Bourdeaux (2011), which documented the reform efforts of the 2000s.

In this study, we provide a detailed synopsis of the different tax reform efforts in the states and the recommendations produced by the commissions, committees or task forces. Furthermore, we provide a snapshot of legislative outcomes of the proposals, but we do not take up a review of the arguments for and against particular pieces of legislation. We focus on individual income, sales and use, property, and corporate income taxes. Furthermore, we examine the types of changes that have been proposed or adopted across these various tax types. We reviewed the tax reform efforts across the country and selected nine states and the District of Columbia because these governments have completed a comprehensive tax review since 2010. We include two additional states, North Carolina and Kansas, due to their comprehensive tax reform through large-scale legislative changes.

The case studies primarily rely on the reports of the commissions and legislative bills. Other sources of information include newspaper reports, academic articles, government websites, interpretation of legislative bills by legal firms, and information from research organizations that focus on tax issues. Wherever possible we have tried to provide information about the legislative changes that have followed the recommendations of commissions. However, the complexity of the legislative process often makes it difficult to attribute legislative changes directly to reform proposals. Lastly, the reform proposals and legislative actions are a continuous process; thus, we may not have included some recent changes. The case studies in this paper should be read with due cognizance of these issues.

A Summary of Tax Reform Efforts

ARIZONA

Arizona established the Transaction Privilege Tax Simplification Task Force in 2012 and the Joint Task Force on Income Tax Reform (JTITR) in 2013. The 2012 tax task force recommended that the state standardize the administration of transaction privilege tax and reduce the cost of compliance for taxpayers. Several recommendations of transaction privilege tax task force were adopted via House Bills 2111 and 2567. The JTITR suggested a series of short-term and long-term changes to the state's income tax system, such as indexing the tax brackets for inflation and a gradual shift towards a single-rate system.

DISTRICT OF COLUMBIA

The Council of the District of Columbia authorized the D.C. Tax Revision Commission in 2011, and it submitted a final report in May 2014. It examined ways to improve tax fairness, broaden the tax base, increase the competitiveness of the district and simplify the tax structure. The report focused on reducing the tax burden on middle-income taxpayers in the district. The 2015 budget adopted by the council introduced several changes based on the recommendations of Tax Revision Commission, such as a reduction in income tax rates and raising the standard deduction.

GEORGIA

The 2010 Special Council on Tax Reform and Fairness for Georgians reviewed the revenue structure of the state and suggested several changes to the personal income, corporate income, and sales taxes. The commission recommended that the state adopt a single income tax rate and eliminate itemized and standard deductions and personal exemptions. The special council also recommended elimination of several economic development tax credits, sales tax exemptions and the sales tax holidays.

HAWAII

In 2010, the state of Hawaii reconvened the Tax Review Commission to review the tax structure. The commission laid out a framework for undertaking tax reform and recommended setting up a special commission on fiscal responsibility and reform to take a detailed look at the state's revenues and expenditures. Two bills that are under legislative consideration, House Bill 886 and House Bill 1355, introduced some of the recommendations of the commission including a special commission on fiscal responsibility.

INDIANA

In 2014, the governor of Indiana organized a Tax Competitiveness and Simplification Conference that discussed several challenges and tax policy alternatives to current methods in Indiana. The conference recommended that the state simplify the individual and corporate income tax codes, and that eventually the state's tax code should move away from individual income tax to taxes on goods and services. The conference participants also suggested the need to broaden the sales tax base and to reduce the state's reliance on corporate taxes. Senate Bill 441 enacted some changes in the business taxes including some conference recommendations such as the elimination of the 'throwback rule'.

KANSAS

The tax reform in Kansas was undertaken through the legislative route. House Bill 2117 in 2012 and House Bill 2059 in 2013 introduced several changes in the individual income and sales taxes. House Bill 2117 reduced the number of individual income tax brackets and lowered the tax rate. It also eliminated the tax on business income reported by sole proprietorships, Subchapter-S Corporations, and single-member limited liability companies. House Bill 2059 expanded upon the reforms of House Bill 2117 including a further reduction in the income tax rate and enacting a revenue trigger provision for further reductions. House Bill 2117 repealed several tax credits including low-income food sales tax rebates and child care expenses.

KENTUCKY

The governor established the Blue Ribbon Commission on Tax Reform to examine the tax code in 2012. The commission argued for a reduction in individual and corporate income tax rates and suggested enacting an earned income tax credit to assist low-income households. It also recommended broadening the sales tax base to include a range of services and luxury items and a property tax exemption for business inventory. In 2014, then-Gov. Steven Beshear unveiled the legislative plan to modernize the state's tax code, but the legislature did not consider the governor's plan.

MASSACHUSETTS

The state established two major commissions in recent years, the Tax Expenditure Commission (TEC) in 2011 and the Tax Fairness Commission (TFC) in 2013. TFC found that the overall tax system in the state is regressive, as low- and middle-income households pay a larger proportion of their income in taxes. TFC suggested several reform options such as a graduated individual income tax rate structure and an increase in the state component of Earned Income Tax Credit to combat the regressive nature of the system. TEC argued for better coordination between the legislature and the governor to identify and publish a clearly articulated policy purpose and desired outcomes for all current and future tax expenditures.

NEW YORK

The governor established a Tax Reform and Fairness Commission in 2012 to undertake a comprehensive review of the state's tax structure. The commission made several recommendations related to sales, individual income, property, and corporate income taxes. The commission also identified several areas for improvement in tax administration and enforcement. The governor's 2014-15 budget adopted some of the recommendations of the commission and introduced changes to the corporate income tax.

NORTH CAROLINA

North Carolina undertook a major tax reform overhauling the tax code through the legislative process. The state passed the Tax Simplification and Reduction Act of 2013 (also called House Bill 998) that included an elimination of personal exemptions, creation of a single individual income tax rate, and an increase of the standard deduction. House Bill 998 also repealed the estate tax and sales tax holiday, and it undertook a major reduction in the corporate income tax rate. The state expanded the sales tax base to service contracts and entertainment activities. In 2015, the Senate suggested some amendments to House Budget Bill 117 that included further reduction in taxes.

OKLAHOMA

In 2011, the Task Force on Comprehensive Tax Reform proposed several changes to the state's personal and corporate income taxes. The commission suggested that state should work towards the elimination of income tax and recommended elimination of the business activity tax and various tax credits. The commission recommended a reduction in the corporate income tax rate from 6 percent to 5 percent. In 2014, the state enacted a reduction in the top marginal individual income tax rate during 2016 and subsequent years contingent on revenue triggers.

SOUTH CAROLINA

The South Carolina Taxation Realignment Commission submitted its report in December 2010. The commission recommended reducing the sales tax rate and broadening the sales tax base by repealing several sales and use tax exemptions. The commission highlighted the complexity of assessment ratios in the state and suggested several measures to improve property tax administration. The commission also proposed several changes to the credits provided by the state. As of this writing, a fuel tax reform in the state is still under deliberation.

Common Themes in Tax Reform Proposals

There are some similarities and common themes across the tax reform proposals that the various state commissions identified. This section outlines some common themes in the reform proposals and initiatives across the various tax types.

PERSONAL INCOME TAX

- All of the states in this report have discussed the need to modify the income tax system. Several states have focused on reduction of the income tax brackets, simplification, and eventually reducing the reliance on income tax. Kansas collapsed its three rate brackets into two; North Carolina adopted a flat tax rate, and the Tax Reform Council in Georgia recommended adopting a flat tax rate. The commissions in Georgia, Oklahoma and Washington, D.C., recommended a reduction in the top marginal tax rate, and the Kansas legislature reduced the top tax rate.
- The attempts toward simplification also have included proposals for elimination of or review of different exemptions and tax credits. The Tax Reform Council in Georgia recommended eliminating itemized deductions, standard deductions and personal exemptions. The tax reform bills in Kansas and North Carolina repealed several tax credits and deductions. The commission in Oklahoma also recommended elimination of several income tax preference items.
- In the aftermath of the recession, several states are paying attention to tax fairness. For example, the Tax Fairness Commission in Massachusetts recommended establishing a graduated income tax in place of the current flat tax rate to make the tax system fairer. States such as Massachusetts and New York have established tax fairness commissions to examine the equity aspect of their tax structure. Other states have introduced legislations aimed at alleviating the tax burden for the lower end of the income distribution. For example, Massachusetts, Washington, D.C., and Kentucky have modified the Earned

Income Tax Credit program to improve assistance to low-income groups, and Georgia proposed a personal tax credit for low-income taxpayers.

SALES AND USE TAX

- The sales and use tax is being increasingly perceived as one of the important sources of revenue for states, and there has been a push toward broadening the sales and use tax base. Kentucky, New York, South Carolina and Washington, D.C., proposed expanding sales and use tax on a variety of good and services, and the legislation in North Carolina brought several new good and services within the bounds of sales tax. Several states have expanded sales and use tax to include different kinds of service contracts (e.g., warranty agreements and repair contracts), entertainment activities and new technological products.
- Several states discussed the need to simplify the sales tax collection procedures and to apply a lower tax rate over a broader base. Arizona undertook a major reform of the Transaction Privilege Tax focusing on simplification. Georgia and South Carolina recommended eliminating various exemptions for sales tax; for example, the commissions in both states recommended repealing the sales tax exemption on groceries. Indiana discussed several options for simplifying the sales tax administration, and the New York commission also highlighted the need to simplify the complex sales tax structure in the state.
- The growing importance of e-commerce and online sales has been one of the important issues in the sales and use tax deliberations across the states. Most of the commissions have expressed the need to support the federal legislation that would allow the states to tax e-commerce sales. State legislatures also are examining the taxation of tangible physical purchases vs. virtual purchases (like the purchase of e-books, renting or streaming of videos, and music and software downloads).

CORPORATE TAXES

- Several states have deliberated on decreasing their reliance on corporate income taxes and a simplification of the administration of business taxes. New York and North Carolina enacted a significant reduction in corporate income taxes. The commissions in Kentucky, Georgia, Massachusetts and Oklahoma discussed a reduction in the corporate income tax rates. States like Indiana, New York and North Carolina have taken several steps to simplify the corporate taxes including simplicity of filing and repealing outdated administrative requirements.
- A number of the states extended tax incentives to businesses in the aftermath of the recession to attract new businesses and aid the existing ones within their jurisdictions. However, most of the commissions have been apprehensive of such incentives; for example, commissions in South Carolina, Hawaii, New York, Georgia and South Carolina have highlighted the need for rigorous evaluation of tax incentives or credits.
- There also has been a substantial discussion about creating tax environments that facilitates the growth of small businesses. For example, Massachusetts' commission recommended adoption of a reduced

corporate tax rate for small businesses, and New York's commission suggested modification in the estate tax to assist middle-class taxpayers as well as small businesses.

- The states also are attempting to bring more transparency and a better regulatory environment for business. Several states have adopted combined reporting requirements to improve transparency and to prevent tax avoidance. Other initiatives include measures to avoid double taxation, changes in apportionment formulas, and simplification of tax administrations.

OTHER THEMES

- Several states have been discussing modifications to the estate tax. House Bill 998 in North Carolina repealed the estate tax in the state, and the commissions in New York and Washington, D.C., suggested modifications to the estate tax law including raising the exemption threshold.
- Improving the administration of property taxes has been a major theme throughout a majority of the tax review commissions. New York and South Carolina have focused on updating and simplifying the assessments; other states have considered simplification measures like implementing online systems and improving the coordination between departments of taxation (or equivalent authorities) and the local governments.
- Several states are considering a reduction in the tax rate subject to revenue triggers. For example, the House Bill 2059 in Kansas enacted a revenue trigger provision for income tax rate reductions. Also, the House Bill 998 in North Carolina adopted a rate reduction trigger for corporate income tax, and Senate Bill 1246 enacted a reduction in the top marginal individual income tax rate contingent on certain revenue triggers.
- Improving and simplifying tax administration has been an integral component of the tax reform proposals. The legislative action (e.g., North Carolina) and review exercises (e.g., Indiana) have primarily focused on simplification. Apart from modifications to the tax code, the states have discussed various alternatives related to technological modernization, better forecasting models, standardizing administrative procedures, and improving audits and enforcement.

Case Studies

ARIZONA

Overview of Initiatives

In May 2012, then-Gov. Jan Brewer established the Transaction Privilege Tax Simplification Task Force through an executive order to identify and recommend steps for simplifying the sales tax code and improving tax compliance. The task force submitted its final report in December 2012. The president of the Senate and speaker of the House of Representatives established the Arizona legislature's Joint Task Force on Income Tax Reform (JTITR) in August 2013. The task force submitted its report in December 2013.

Key Reform Proposals

TRANSACTION PRIVILEGE TAX (TPT)

- The task force recommended elimination of the TPT exemption on sales of tangible personal property that was shipped directly to an international destination.
- Arizona did not tax materials for construction at the point of sale; instead, it taxed prime contracting activities that led to complexities within tax administration. The TPT task force recommended the move towards taxing materials at the point of sale.
- The task force suggested that there would be a significant improvement in enforcement if a single statewide agency (Department of Revenue) conducted all the tax audits.

CORPORATE INCOME TAX

- The JTITR recommended a permanent increase in the expensing allowance to $500,000, allowing businesses to treat qualifying property as an expense rather than capital expenditure.
- It also suggested an increase in the bonus depreciation allowance for new equipment to 50 percent to match the existing federal allowance.

INDIVIDUAL INCOME TAX

- For single and joint filers, the task force recommended indexing the income tax brackets for inflation.
- The task force recommended that the current graduated rate individual income tax model should move towards a single rate model to remain economically competitive.
- The task force suggested several other changes, such as reducing the tax audit period from four to three years, and electronic filing of individual income tax returns to the state Department of Revenue.

Results/Outcomes

The subsequent legislative changes incorporated several recommendations of the commissions. House Bills 2111 and 2567 of 2013 attempted to simplify the administration of the Transaction Privilege Tax.

- The House Bill 2111 led to the centralization of the administration of the local TPT. It also repealed the exemption on international sales.
- House Bill 2567 introduced several changes to transactions by contractors including the shift from taxation of the contractor’s receipts to a retail tax on construction materials.
- To improve the coordination between cities, counties and the state Department of Revenue, House Bill 2567 proposed that businesses should no longer have to go through audits by both the state and municipal tax authorities. Starting Jan. 1, 2015, the state Department of Revenue became the single agency responsible for administration of the municipal, county and state transaction privilege taxes.
- In 2014, House Bill 2664 that would have permanently set the business expensing allowance to $500,000 was vetoed by the governor.

Key Sources

(Arizona Department of Revenue, 2014; JLBC Staff Report, 2014; Joint Task Force on Income Tax Reform, 2013; PwC, 2013a; The State of Arizona, 2013a, 2013b; Transaction Privilege Tax Simplification Task Force, 2012)

DISTRICT OF COLUMBIA

Overview of Initiatives

The Council of the District of Columbia authorized the D.C. Tax Revision Commission in September 2011, 13 years after the last comprehensive tax review in 1998. The commission held several public meetings and hearings during 2012 and 2013 and submitted its final report in May 2014. The commission examined the ways to simplify the tax code and make it fairer.

Key Reform Proposals

INDIVIDUAL INCOME TAX

- The individual income tax in the district had eight filing statuses and four brackets. The commission recommended that the district conform to the five federal filing statuses and create separate income tax brackets for singles and married couples.
- The commission recommended a new middle-class tax bracket at 6.5 percent, reduced from the previous 8.5 percent for those earning $40,001 to $60,000 for single filers and $40,001 to $80,000 for married filers.
- The commission proposed a reduction in the top marginal tax rate from 8.95 to 8.75 percent for those earning more than $350,000.
- The commission also recommended raising the standard deduction from $4,100 to $6,100 for singles, $8,950 for the head of household and $12,200 for married filers by 2017.
- The commission recommended raising the district's personal exemption from $1,675 to $3,900, and suggested a phase-out of personal exemptions for taxpayers with more than $150,000 (for single filers) or $200,000 (for married filers) adjusted gross income.
- The commission recommended an increase in the maximum D.C. Earned Income Tax Credit for childless workers from $195 to $487 per filer.

BUSINESS TAX

- In D.C., the Business Franchise Tax (BFT) applies to corporations. The Unincorporated Business Franchise Tax (UBFT) applies to unincorporated businesses with more than $12,000 in annual business income. The commission recommended that the district reduce its BFT/UBFT from current the 9.975 percent rate to 8.250 percent.
- The commission also noted that investment funds in the district operating a stock trading business are subject to the BFT; discouraging them from conducting business in the district. The commission recommended exempting such funds from the tax.

- The commission recommended levying a local services fee on non-government D.C. employers of $25 per employee per quarter, exempting businesses with four or fewer employees.
- In 2011, the district started to double-weight the sales factors to apportion business income. The commission suggested using only the sales occurring within district boundaries.

SALES AND USE TAXES

- The commission noted that an increase in sales tax rate could help fund more advantageous tax relief, such as a middle-class income tax bracket and a lowered business franchise tax rate. Thus, it recommended an increase in the general sales tax rate from 5.75 percent to 6 percent.
- The commission recommended expansion of the sales tax to new services (e.g., construction contractors, storage of household goods, health clubs, etc.) and suggested the council should continue exploring other services that can be taxed.
- The commission suggested the addition of a line in the personal income tax return to identify the use tax obligations, encouraging online shoppers to pay the tax.
- The commission proposed the adoption of a unified system of taxation of tobacco products equal to 80 percent of the wholesale price. The Commission also suggested that the district should broaden its definition of other tobacco products to include all the products that “contain tobacco or is made or derived from tobacco.” All these tobacco products would be taxed at the same rate.

OTHER TAXES

- The commission suggested no change in the property tax rate.
- It rejected the proposals for lowering the tax rate on commercial property and for changing the residential property minimum taxable assessment.
- The commission observed that the district’s estate tax formula is linked to an obsolete federal law. The commission recommended increasing the estate tax exemption threshold from $1 million to $5.25 million and adopting a graduated rate schedule with four brackets.

Results/Outcomes

The council proposed the implementation of some of the important recommendations and voted on some of the recommendations in 2014. The budget of the fiscal year 2015 included several changes based on commission recommendations.

- The budget reduced the income tax rate from 8.5 percent to 7 percent (income $40,000 to $60,000 for individuals and $80,000 to $120,000 for families with two earning members).
- The commission had proposed cutting down the top marginal income tax rate from 8.95 percent to 8.75 percent. However, the 2015 budget included the reduction only for income up to $1 million. Thus, creating a new tax bracket for incomes $350,000 to $1 million.
- The 2015 budget also raised the standard deduction from $4,250 to $5,200 for singles and to $8,350 for married couples, thus partially implementing the commission’s recommendation.

- A use tax line on personal income tax returns to nudge filers to pay use tax on remotely purchased items was introduced. However, this would not affect the revenues until 2016.
- The budget also incorporated several recommendations of the commission on tobacco taxes like broadening the definition of tobacco products as per the commission's recommendation.

Key Sources

(DC Fiscal Policy Institute, 2014; D.C. Tax Revision Commission, 2014; Henchman, 2014b)

GEORGIA

Overview of Initiatives

The Special Council on Tax Reform and Fairness for Georgians was established by House Bill 1405 in 2010 to review the tax revenue structure of the state and submitted its report in January 2011. The council undertook a comprehensive study of the state's revenue structure and provided several recommendations regarding a range of tax instruments.

Key Reform Proposals

PERSONAL INCOME TAX

- The tax reform council highlighted the complexity of Georgia's tax system and recommended that a single, flat tax rate replace the six tax brackets. It proposed a gradual reduction in the top marginal income tax rate from 6 percent to 5 percent in 2012, 4.5 percent in 2013 and 4 percent in 2014.
- The council also recommended the elimination of all itemized deductions, the standard deduction and personal exemptions for taxpayers. The council also suggested a reduction in the personal exemption amount to $2,000 per dependent.
- The council endorsed establishing a personal credit based on income and number of dependents that can get low-income taxpayers back to tax neutrality.
- The council also proposed a phase-out of the $35,000 retirement income exclusion limit.
- The council recommended the elimination of most of these tax credits in the state. However, the council recommended continuation of credits for:
  - Income tax in other states
  - Energy and water efficient products (federally funded)
  - Angel investors (has a sunset provision)
- The council recommended a closer examination of treating residents' out-of-state income similar to that of taxable non-residents. However, it did not propose a formal review.

CORPORATE TAX

- The tax reform council recommended maintaining parity in tax rates for individuals and corporations, requiring the reduction of corporate tax rates to match the personal income tax rates.
- The council recommended the elimination of all economic development tax credits.

- The council recommended the creation of a fund, subject to an annual limit, that allows the state Department of Economic Development to provide incentives in attempt to attract new and existing businesses that are planning to locate in or expand in Georgia.

SALES AND USE TAX

- The tax reform council suggested that the exemptions scheduled to sunset be examined carefully before considering renewal. It also recommended elimination of certain exemptions such as exemption on sales of certain equipment to film producers.
- The council recommended elimination of exemption on food purchased for home consumption.
- The council argued for continuing the exemptions for government purchases, business inputs, and inputs for agriculture and manufacturing.
- The council also recommended creating a new exemption for energy used in agriculture, manufacturing and mining. This included several energy categories like diesel, electricity, wood and natural gas.
- The council recommended that the state fully comply with the Streamlined Sales and Use Tax Agreement (SSUTA). Furthermore, the council suggested that laws be passed to allow for the collection of sales and use tax on remote purchases through inciting voluntary compliance.
- The council recommended that the legislature not re-legislate the sales tax holiday because the exemption appears to have no effect on net consumption.

OTHER TAXES

- The council proposed an increase in the cigarette tax from $0.37 to $0.68 a pack. They arrived at this tax rate based on the cigarette taxes in neighboring states. The council also recommended that for the future years the tax rate should be indexed for inflation.
- The council suggested converting the state’s motor fuel tax from an ad-valorem to per unit tax.
- The council recommended replacing the sales and use tax (and franchisee fee) on communications services (excluding Internet access services) with a 7 percent excise tax. To avoid tax pyramiding, the council recommended an exemption for business activities of communication service providers.

Results/Outcomes

- The Transportation Funding Act of 2015 created a Special Joint Committee on Georgia Revenue Structure to introduce tax reform legislation in the 2016 legislative session.
- In 2015, House Bill 445 has proposed several changes in the tax structure of the state including several proposals from the commission regarding income and sales tax. The bill is still under consideration.
- In 2012, the Georgia House Bill 386 and House Bill 868 enacted some proposals of the commission such as eliminating sales tax on certain inputs for agriculture and manufacturing.
- Most of the recommendations of the commission such as eliminating exemptions and tax credits, eliminating sales tax holiday, and changes in individual income taxes were not enacted.

Key Sources

(Georgia General Assembly, 2012a, 2012b, 2015; Special Council on Tax Reform and Fairness for Georgians, 2011; The Economist, 2012)

HAWAII

Overview of Initiatives

Every five years, Hawaii entrusts the Tax Review Commission with examining the equity and efficiency of the state's system of taxation. The 2010-2012 Tax Review Commission was established to undertake a comprehensive review of the tax structure. The commission examined the challenges of the state's growing budget deficits and presented its recommendations to the Hawaii legislature in November 2012.

Key Reform Proposals

PERSONAL INCOME TAX

- The commission recommended that the state increase food/excise credits and low-income household renters' credits for individuals below the federal poverty line. The commission also suggested increasing the standard deduction and personal exemption for such individuals.
- The commission deliberated on taxing retirement income and suggested that the state not make further changes until the pending review of taxable 401(K) and other deferred compensation plans is completed. However, if the state decides to repeal the pension exemption, the commission recommended incorporating a delayed phase-out with grandfather provisions and an annual base amount exclusion.

SALES AND USE TAX

- The commission urged the Hawaii congressional delegation to support and enact federal legislation that addresses the United States Supreme Court decision in Quill Corp v. North Dakota 504 U.S. 298 (1992) to allow states to tax e-commerce sales and collect needed revenues.

BUSINESS TAXES

- The commission also recommended that the economic tax incentives provided to businesses be linked to performance, follow proper disclosures, and contain a sunset/review date to examine costs and benefits.

OTHER RECOMMENDATIONS

- The commission recommended augmenting the tax collection and enforcement efforts of the state Department of Taxation. This included efforts towards technological modernization, increase in staff, and support for amnesty and voluntary compliance programs.
- The commission also recommended the use of forecasting models to develop the comprehensive revenue plans.
- Furthermore, it recommended the creation of a commission on fiscal responsibility and reform that could undertake a comprehensive review of revenues and expenditures in the state.

Results/Outcomes

- The House Bill 886 introduced in 2015 (but not yet adopted) proposed several changes to income tax with an overall goal of reducing income inequality. The bill proposed an increase in low-income household renters' credit and refundable food/excise tax credit as per the suggestions of the tax commission.
- The House Bill 1355 introduced in 2015 proposed establishing the Commission on Fiscal Responsibility as recommended by the Tax Review Commission. The bill is still under consideration.

Key Sources

(Tax Review Commission, 2012; The PFM Group, 2012; The State of Hawaii, 2015a, 2015b)

INDIANA

Overview of Initiatives

The state of Indiana introduced significant changes to its tax structure over the past several years. In 2014, the governor led an effort to simplify the tax code and organized a Tax Competitiveness and Simplification Conference that brought together tax experts, academics and practitioners to discuss best practices. The conference published a report in September 2014 with several recommendations for simplifying the tax structure.

Key Reform Proposals

INCOME TAX

- The Tax Competitiveness and Simplification Conference recommended the state simplify income taxation by reducing the number of modifications and exemptions.
- The conference recommended indexing the personal exemptions for inflation to make the tax system more progressive and to help make the exemptions in Indiana comparable to other states.
- The conference also recommended several steps for simplifying the local option income taxes such as consolidation of all counties under a standard structure.
- The conference suggested that eventually the state's tax code move away from taxes on income to taxes on goods and services.

SALES TAX

- The Tax Competitiveness and Simplification Conference suggested that the state attempt to broaden the sales tax base to allow a lower overall rate.
- The conference suggested that the state adopt a "single direct test" that focuses only on whether the purchase was made by the business as an input or not.
- The conference suggested that the state clarify rules for taxing new computer technologies, like cloud computing and new software applications.

- The construction contractors in the state have to go through different tax treatment depending on whether they bill the customer in a lump-sum contract or a time-and-material contract. The conference recommended simplification and clarification about taxes on construction contracts.

CORPORATE INCOME TAX

- The conference suggested the state reduce its reliance on the corporate income tax because it may affect the economic activity in the state.
- The conference proposed several steps to improve the corporate tax system including the elimination of "throwback rules," broadening the definition of service income, and other simplification measures.

OTHER TAXES

- The conference suggested the existing Utility Receipts Tax be eliminated or be transformed into a consumption tax.
- The conference suggested several steps for improving the efficiency of property taxes such as modification of the filing rules and introduction of mandatory e-billing system
- The conference also discussed several steps to improve tax administration in the state. Some of the key suggestions included reallocation of the settlement authority, devoting more resources to dispute resolution, and standardizing administrative protest procedures.

Results/Outcomes

- The House Bill 1349 introduced in 2015 proposed elimination of the double direct test on for determining sales and use tax as per the recommendation of the conference.
- The state approved gradual reduction in personal income tax rate from 3.4 percent to 3.3 percent in 2015 and 3.23 percent in 2017.
- In May 2015, the Senate Bill 441 eliminated the taxation of income from a state that does not have an income tax, "the throwback rule" as per the recommendation of the conference. It also introduced several changes for business, including amending the definition of business income as "all income apportionable to the state under the Constitution of the United States."

Key Sources

(Drenkard, 2015a; Indiana General Assembly, 2010, 2015a, 2015b; Indiana Tax Competitiveness and Simplification Conference, 2014; PwC, 2015; State Budget Agency, 2013; Tax Foundation, 2013, 2014, 2015)

KANSAS

Overview of Initiatives

Kansas made significant changes to its tax laws through House Bill 2117 in 2012, which was primarily aimed at changes in the individual income tax. House Bill 2059 in 2013 extended and modified the reforms. The adoption of tax reforms in Kansas significantly lowered tax rates without making progress in broadening the tax base.

Key Reform Proposals

INDIVIDUAL INCOME TAX

- House Bill 2117 made significant changes to the income tax rates and deductions in Kansas in 2012.
  - The law collapsed the existing three rate brackets to two and lowered the top rate from 6.45 percent to 4.9 percent. The law reduced the rate for the lowest bracket from 3.5 percent to 3.0 percent. The income threshold to qualify for the lower bracket is $15,000 or less for single filers and $30,000 or less for married filers.
  - The law increased the standard deduction.
    - Married, filing joint, increased from $6,000 to $9,000.
    - Single, filing head of household, increased from $4,500 to $9,000.
  - The law repealed several tax credits previously allowed to individuals, including but not limited to:
    - Low-income food sales tax rebates
    - Adoption expenses
    - Child and dependent day care expenses
    - Small employer health benefit plan contributions (In Kansas, any employer having two to 50 employees is permitted to establish a health benefit plan for employees).
  - The exemption of specific types of income from net taxable income calculations:
    - The law exempted from state income taxes all business income reported by sole proprietorships; Subchapter-S Corporations; and single-member, limited liability companies.
    - The exemption of net farm profit.
    - Income from rental real estate, royalties or net farm rental.
- House Bill 2059, signed in 2013, further reduced the income tax rates and modified scheduled changes in standard deductions.
  - The law established a schedule (from 2014 to 2018) for lowering the tax rate of the top bracket from 4.9 percent to 3.9 percent and the lower bracket rate from 3 percent to 2.3 percent. The income threshold to qualify for the lower bracket is $15,000 or less for single filers and $30,000 or less for married filers.
  - House Bill 2059 also introduced several changes to itemized deductions. Most of the itemized deductions (except for charitable contributions) were reduced by 30 percent for 2013 with an additional 5 percentage points incrementally each year until 2017. The law completely repealed deductions for certain gambling losses. The deduction for charitable contributions was fully retained.
  - The law reduced the increase in standard deduction scheduled for July 2013.
    - Married, filing joint, lowered deduction to $7,500 (vs. $9,000 in House Bill 2117).
    - Single, filing head of household, lowered deduction to $5,500 (vs. $9,000 in House Bill 2117).
  - The law enacted a revenue trigger provision for further income tax rate reductions (beginning in fiscal year 2018) if selected actual state general fund receipts exceed the previous fiscal year's receipts by more than 2 percent.

SALES TAX

- In 2010, Kansas increased the state sales tax rate from 5.3 percent to 6.3 percent with a scheduled decrease to 5.7 percent in 2013. The House Bill 2117 legislation in 2012 did not change this plan but the House Bill 2059 set the state sales tax rate at 6.15 percent, effective July 1, 2013.
- The law partially restored the low-income food sales tax rebate program. However, the tax credits under the program were no longer refundable.
- House Bill 2117 repealed the Food Sales Tax Rebate that was targeted tax relief for low-income individuals who were from at least one of three categories:
  - Elderly
  - Disabled
  - Young Dependents in Household

Results/Outcomes

- The Kansas tax reform was mostly led by legislative changes summarized above.
- In 2015, lawmakers considered a number of proposals to address the budget gap but most of them are still being debated.

Key Sources

(Joseph & Drenkard, 2013; Kansas Legislative Research Department, 2012, 2013; Leachman & Mai, 2014; Robyn, 2012)

KENTUCKY

Overview of Initiatives

In February 2012, the governor established the Blue Ribbon Commission on Tax Reform to recommend ways to make the tax code more responsive to the economic fluctuations and to make the tax system more equitable. The commission undertook an assessment of taxes paid by Kentucky residents compared to other states, and it examined the tax structure with a focus on simplicity as it relates to compliance, fairness, equity and competitiveness. The commission submitted the final report to the governor at the end of 2012.

Key Reform Proposals

INCOME TAX

- The commission recommended a reduction to the individual income tax rates for Adjusted Gross income higher than $4,000:
  - $4,001 to $5,000: 4.0 percent to 3.5 percent
  - $5,001 to $8,000: 5.0 percent to 4.5 percent
  - $5,001 to $8,000: 5.0 percent to 4.5 percent
  - $8,001 to $75,000: 5.8 percent to 5.5 percent

  - More than $75,001: 6.9 percent to 5.8 percent
- Enact an Earned Income Tax Credit (EITC) at 15 percent of the federal EITC.
- Limit itemized deductions to $17,500.
- Lower the pension exclusion income from $41,110 to $30,000, and phase out the exclusion for total incomes above $30,000.

CORPORATE INCOME TAX

- The commission suggested lowering the top corporate income tax rate from 6 percent to 5.8 percent.
- The commission recommended a change from the three-factor apportionment formula to a single-factor formula, based only on sales.
- The commission noted that the revenue threshold in the limited liability entity tax is significantly high, and it suggested lowering the small business revenue threshold from $3 million to $1 million.
- Add management fees into the calculation of the corporate income tax base.

SALES AND EXCISE TAX

- Impose 1 percent gross receipts tax on both residential and business utilities, and dedicate additional revenues to the Support Education Excellence in Kentucky (SEEK) fund.
- Increase the sales tax on cigarettes from $0.60 to $1.00 per pack, and raise sales tax on other tobacco products by a commensurate amount.
- Broaden the sales tax base to include new items such as luxury goods and services, services that have inelastic demand, and services that have a clear nexus in Kentucky. The commission also recommended applying sales tax and transient room taxes to the entire hotel accommodation price.
- The commission recommended amending Section 181 of the state constitution to allow for a local option sales tax.

PROPERTY TAX

- Exempt inventory (such as merchant's inventory, manufactured or finished goods, or those stored in warehouse) from the state property tax. The commission also proposed some income tax credits for the bourbon industry to offset the property tax on inventory.
- Freeze the state property tax rate at 12 cents per $100 of value.

Results/Outcomes

The commission's report outlined an expected net annual fiscal impact of $645 million to the state's general fund from its income, sales and property tax proposals.

- In 2014, then-Gov. Steven Beshear unveiled his legislative plan to modernize and reform Kentucky's tax code.
- The governor's plan was based on the commission's recommendations to a significant extent. The Kentucky legislature did not consider the governor's plan in 2014. In 2015, Beshear did not re-submit his plan.

Key Sources

(Blue Ribbon Commission on Tax Reform, 2012; Henchman, 2012; Office of the Governor, 2014; Stone, 2014)

MASSACHUSETTS

Overview of Initiatives

In 2011, the Massachusetts legislature established the Tax Expenditure Commission (TEC) to carefully review the administration and fiscal impact of tax expenditures. TEC submitted its report in April 2012. The Massachusetts legislature established the Tax Fairness Commission (TFC) in 2013 to analyze the broad array of tax laws within the state, with a focus on the equity of current tax policies. The TFC submitted its final report on March 1, 2014.

Key Reform Proposals

INCOME TAX

- TFC recommended establishing a graduated income tax through a constitutional amendment. Massachusetts currently applies a flat tax rate of 5.15 percent to all wages, pensions, business income, rents and other income. Five previous ballot attempts, from 1962 to 1994, to approve the required constitutional amendment were unsuccessful.
- Increase the state-funded match of the federal Earned Income Tax Credit from its current 15 percent rate, but the commission did not recommend a specific value.
- Raise the current personal exemption on single filers, heads of households, and married couples filing jointly.

PROPERTY TAX

- Expand eligibility for the property tax circuit breaker for senior citizens to also include low-income individuals and families (total income less than $55,000 for single; $69,000 for head of household and $82,000 for married joint filers).

SALES TAX

- Once Congress grants states' the authority to tax online sales, the commission recommended the state enact legislation that allows the state Department of Revenue to enforce the assessment and collection of sales and use tax for online purchases.

CORPORATE TAXES

- The TFC suggested the following policy alternatives to improve the state's economic competitiveness:
  - Reducing or eliminating the minimum corporate excise tax
  - Reducing the overall corporate excise tax rate
  - Exploring the possibilities of adopting a Super Research and Development Tax Credit and an Alternative Simplified Research and Development Tax Credit

    - Adopting a reduced corporate tax rate for small businesses that gross less than $1 million a year to improve competitiveness of the state (The commission did not specify the tax rate, but it discussed the tax rates in other neighboring states, such as New York.)

Results/Outcomes

- In 2015, Gov. Charlie Baker introduced a proposal to double the EITC credit in Massachusetts, to be paid for by eliminating the state's film tax credit. Although the governor's plan has met significant opposition from lawmakers in favor of the film tax credit, support for the expanded EITC program is growing in the legislature.
- The state did not act on the commission's recommendation to institute a graduated income tax, but it reduced the income tax rate from 5.20 percent to 5.15 percent effective Jan. 1, 2015.

Key Sources

(Tax Expenditure Commission, 2012; Tax Fairness Commission, 2014)

NEW YORK

Overview of Initiatives

The governor established the New York State Tax Reform and Fairness Commission in December 2012 to undertake a comprehensive review of state's tax structure, including its corporate, sale, estate and personal income taxes. The commission submitted its final report in November 2013.

Key Reform Proposals

SALES TAX

- The tax reform commission suggested modernizing the sales tax to be more adaptable to shifts in consumer spending and technological advances. The commission noted the state foregoes approximately $35 million per year by not taxing digital products, such as e-books, music and video streaming, and digital downloads.
- The commission found the current sales tax structure unduly complex, complicating voluntary compliance. It recommended taking steps to address this issue. The suggestions included reduction in the frequency of filing for small businesses and better coordination between the state and New York City with respect to corporate tax audits.
- The commission recommended several options for sales tax reform:
    - Repealing the exemption for clothing and footwear items costing less than $100
    - Including digital products in the sales tax base (e.g., e-books, iTunes downloads)
    - Improving the alignment between sales tax base and current consumption trends.
    - Establishing a reserve fund to finance future real property tax and personal income tax relief.

ESTATE TAX

- The Tax Reform and Fairness Commission suggested modifying the estate tax to relieve the burden on the middle-class taxpayers and small businesses. It argued that the estate tax was based on an outdated federal law from 1998 and should be modified.
- The commission recommended several options for reforming estate and gift tax:
  - Increasing the exemption of the estate tax from $1 million to $3 million
  - Repealing the generation-skipping estate tax
  - Reinstating the gift tax
  - Removing the loophole relating to the resident trust

CORPORATE TAX

The commission noted that the state has not made any significant changes to the method of taxing corporations and financial institutions since the 1940s. Thus, there are several areas that require reform.

- The commission provided several suggestions for corporate tax reform including:
  - Restructuring the corporate tax so as to merge the bank tax into the corporate franchise tax
  - Reforming the Investment Tax Credit by repealing the financial services investment tax credit
  - Evaluating the effectiveness of the business tax incentives by conducting periodic review of the costs and benefits as well as analyzing if they are meeting goals

PROPERTY TAX

- The commission noted that the existing local property tax system in the state is highly fragmented, with a lack of clarity about assessments and outdated assessment rolls. The commission recommended four options for reforming the real property administration:
  - Establishing a clear, statutory standard of assessment
  - Regularly updating assessments at specific intervals, no less than every five years
  - Providing state aid to encourage more use of shared assessment services or consolidation of assessing units
  - Making provisions for the assessment of complex properties (e.g., power plants) at the state level

Results/Outcomes

- The governor signed the 2014-15 executive budget legislation that enacted several reforms to the corporate income tax including a reduction in the tax rate from 7.1 percent to 6.5 percent. According to the new law, the entire net income base is replaced with a tax based on business income that is calculated by entire net income minus investment income and other exempt income.
- Under the 2014-15 state budget, four tax bases for calculating corporate tax were reduced to three in 2015, and it will be further reduced to two over time by eliminating corporate alternative minimum tax base and capital stock base

- The state eliminated the bank franchise tax, and now all corporations are subjected to a revised corporate franchise tax.

Key Sources

(City of New York, 2015; Department of Taxation and Finance, 2015; Grant Thornton, 2014; Henchman, 2014a; PwC, 2013b; Tax Reform and Fairness Commission, 2013)

NORTH CAROLINA

Overview of Initiatives

The North Carolina legislature passed the Tax Simplification and Reduction Act of 2013 (also called House Bill 998). Following this overhaul, North Carolina legislators implemented several additional changes to the state's tax code in 2014 and 2015. The state made significant changes that included the elimination of personal exemptions, the creation of a single income tax rate, an increased standard deduction, and fewer tax breaks.

Key Reform Proposals

INDIVIDUAL INCOME TAX

- House Bill 998 replaces the graduated personal income tax rate in North Carolina with a flat tax rate.
  - The tax rate has been lowered from three brackets between 6 and 7.75 percent to a single rate of 5.8 percent in 2014 and 5.75 percent for post-2014 taxable years.
- The act increased the standard deduction to $7,500 for single and $15,000 for married filers.
- The act repealed deductions of retirement income, severance wages, 529-plan contributions and several others. Unlimited deductions for charitable contributions were retained.
- It repealed a $50,000 deduction for net business income for small businesses. The deduction was effective for two years, 2012 and 2013, and it allowed an individual to deduct $50,000 of net business income and married filers to deduct $100,000.
- The act eliminated several tax credits (such as credits for disability, educational expenses, certain donations and charitable contributions) but increased the per-child tax credit from $100 to $125 for single filers up to $20,000 and married filers up to $40,000.
- The law enacted a cap of $20,000 on mortgage interest and property tax deduction.

CORPORATE TAX REFORM

- The new law reduces the corporate income tax from 6.9 percent to 6 percent in 2014 and subsequently to 5 percent in 2015. It also introduced a rate reduction trigger (e.g., reducing the corporate income tax to 4 percent in 2016 and 3 percent in 2017) if the state meets certain revenue targets.
- The act also extended the research and development credits to January 2016, and it allowed the film production tax credit to expire in 2015.

SALES AND USE TAX

- To expand the tax base, the act extended the sales tax to service contracts, such as warranty agreements and repair contracts.
- The commission also recommended expanding the sales tax to entertainment activities (such as charges for live performances, movies and museums) and some other goods and services.
- House Bill 998 also repealed sales tax holidays like the back-to-school tax holiday.
- The commission capped sales tax refunds for nonprofits at $31.7 million.

OTHER TAXES

- The act eliminated the North Carolina estate tax.
- House Bill 998 eliminated the business privilege license tax effective from July 1, 2014.
- The state's excise tax on motor fuel was capped at 37.5 cents per gallon until June 30, 2015.

Results/Outcomes

- The North Carolina tax reform was largely led by legislative changes summarized above.
- In 2015, House Bill 117 introduced several new changes in the tax code and is still under consideration. The suggested changes include reduction in the personal income tax rate, a new sales tax on services, and several changes to corporate taxes.

Key Sources

(Cuddy, 2013; Drenkard, 2015b; General Assembly of North Carolina, 2013; Office of the Governor, 2013; Sahadi, 2013; North Carolina Department of Revenue, 2013)

OKLAHOMA

Overview of Initiatives

The Task Force on Comprehensive Tax Reform was created during the 2010 legislative session through Senate Joint Resolution 61. It submitted its final report to the Oklahoma legislature in December 2011. The commission proposed various changes to the state's personal and corporate income taxes, as well as the elimination of the business activity tax and various tax credits.

Key Reform Proposals

PERSONAL INCOME TAX

- The task force recommended that the state attempt to reduce the individual income tax in a revenue-neutral manner. The commission noted that changes to the income tax should accompany a thorough review of tax preferences, preserving the revenue stream for core government services and simplifying the tax structure.
- The task force additionally proposed a simplification of the tax structure and reductions in quarter-point increments to the top marginal income tax rate from 5.25 percent to 4.75 percent over a two-year time span.

- The commission proposed eliminating a series of income tax preference items over a two-year period. Some of the tax preference items with high revenue impact included childcare, agricultural processing facilities, investment in rural small business ventures, and Oklahoma Earned Income Tax Credit.

CORPORATE INCOME TAX

- The task force suggested a reduction in the corporate income tax rate from 6 to 5 percent, offset by the elimination of tax credits favoring corporations and “narrow business interests,” such as credits for coal production and energy efficient residential construction.

OTHER RECOMMENDATIONS

- The task force recommended that the Business Activity Tax expire at the end of 2012, and that the franchise tax be eliminated entirely to simplify taxation of business activity in the state.
- The task force recommended the state’s corporations adopt combined reporting accounting practices to minimize tax avoidance.
- The task force recommended that if federal legislation to ensure collection of taxes on online sales is enacted, then the additional sales tax revenue can be used for a quarter-point reduction in the top marginal income tax rate.
- The task force recommended a set of criteria for the evaluation and adoption of future tax credits. Some of the suggestions included the elimination of transferability, audits of businesses that utilize credits, mandatory fiscal impact statements, a job creation requirement, fiscal limitations, increased transparency and sunset dates.

Results/Outcomes

- In the state’s fiscal year 2013 executive budget, Gov. Mary Fallin proposed a major reform of Oklahoma’s personal income tax system. It called for reducing the number of tax brackets from seven to three, lowering the top marginal rate from 5.25 to 3.5 percent, and eliminating certain income tax credits.
- The Senate Bill 1246 enacted a reduction in top marginal individual income tax rate from the current 5.25 percent rate to 5.0 percent in 2016 and 4.85 percent subsequently, contingent on revenue triggers.
- The Business Activity Tax was repealed starting in January 2013, and the franchise tax was reinstated.

Key Sources

(Blatt, 2011; Oklahoma Tax Commission, 2014; The State of Oklahoma, 2011)

SOUTH CAROLINA

Overview of Initiatives

South Carolina established the Taxation Realignment Commission (TRAC) through the passage of Act 81 in 2009. The commission was entrusted with the responsibility of a thorough assessment of the state’s current tax structure to determine its adequacy, fairness and efficiency. The commission submitted its final report in December 2010.

Key Reform Proposals

SALES AND USE TAX

- The commission recommended repealing or amending more than 60 of 80 sales and use tax exemptions provided by the state. For example, the list included removing the exemptions on prescription medicine, motor-fuel, groceries and residential electricity.
- The commission also noted that the state taxes only 20 percent of the services that Federation of Tax Administrators have identified as taxable. Thus, the commission recommended repealing the exemptions for several services and expanding the sales tax to some additional goods and services, like personal care services and communication services.
- The commission noted that taking some of these steps would enable the state to reduce its sales tax rate to anywhere between 4 and 5 percent from its current rate of 6 percent, which would be instrumental in improving the state's economic competitiveness.

INDIVIDUAL INCOME TAXES

- The commission noted that South Carolina remains a low-income tax state, but it expressed concern over the narrowing of the individual income tax base and recommended several steps to broaden it. Specifically, the commission recommended the following steps:
  - All of the resident tax filers have either a certain minimum level of South Carolina Adjusted Gross Income (AGI) or those who have to file a federal return will pay a nominal fee to the state irrespective of their tax liability ($25 for AGI between $5,000 to $49,999; $50 for AGI $50,000 to $99,999 and $75 on AGI above $100,000).
  - Cap the standard deduction and personal exemption at the 2009 tax year level such that the state's deduction and exemption remain comparable to neighboring states. The exclusion of the portion of the capital gain tax that had been held for more than a year should continue, but the exclusion should be reduced from 44 percent to 20 percent.
  - Further examination of the seeming disparity between the tax treatments of non-elderly vs. elderly taxpayers.

CORPORATE INCOME TAXES

- The commission recommended that the corporate income tax rate paid by the banks should be similar to those paid by other businesses. Furthermore, the commission recommended the same tax treatment for credit unions, saving and loans, and other financial institutions.
- The commission suggested several changes to the tax credits in the state.
  - Reducing the maximum credit amount from $8,000 to $6,000
  - Eliminating the credits for retail and service jobs
  - Amending the research and development credit to make it look similar to the federal credit

- The commission recommended adoption of combined reporting for corporate income taxation or improvements to the separate reporting methods.
- The commission suggested the state consider adoption of the IRS Circular 230 in its entirety to avoid the practice of contingency fee tax planning. IRS Circular 230 outlines the rules for practicing before the IRS.

PROPERTY TAXES

- The commission highlighted the complexity of assessment ratios in the state and made several small recommendations to improve the state's property tax administration.
- The commission noted that the taxes on non-primary residences (homes and apartments) are significantly higher, and that affects the real estate market in South Carolina. The commission recommended equalizing the tax preference for primary and other residences.
- The commission recommended that the General Assembly deliberate on a constitutional amendment to lower the assessment ratios for manufacturers or to change the fee statutes to permit existing facilities without a fee-in-lieu to enter one.
- The commission also recommended repealing personal property taxation for certain entities such as dealers, banks, savings and loans associations, and credits unions.

Results/Outcomes

- In 2015, Gov. Nikki Haley proposed a tax reform to increase gasoline taxes in return for a reduction in the state's personal income tax rate.
- Legislative committees in South Carolina's House and Senate proposed differing plans that include a higher or similar increase in the gas tax in return for a smaller or no decrease in income tax rates. The issue is still being debated.

Key Sources

(Malm & Walczak, 2015; Taxation Realignment Commission, 2010)

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