

Tax Policy and Competitiveness

A presentation to the Legislative Task Force on Income
Tax Reform

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I N S T I T U T E

What Should be Taxed?



Consumption

or

Saving/Investment

What's the Rate Structure?



Flat rate

or

Graduated rates

Principles of Tax Policy



Simplicity

Fairness

Neutrality

Competitiveness

Who is our competition?

The World

Hong Kong

The Nation

States in our region

Kansas

North Carolina

What Does the Economic Literature Conclude?

- ❑ General conclusion: “Taxes have quite large and significant effects on business activity.” (Ladd 1998)
- ❑ High marginal income tax rates negatively impact income growth and employment growth.
- ❑ States without income taxes (or with predominantly consumption-based taxes) grow faster than those with income taxes. Revenue volatility is also lower.
- ❑ States with less progressive rates structures grow faster than those with more steeply graduated rates.

Federal Reserve Bank of Minneapolis



Tax progressivity inhibits growth, and the “reform in the structure of taxes has more of an effect than reform in the *level* of taxes alone.”

Source: “Does the Progressivity of Taxes Matter for Economic Growth?” (2000)

Organization of Economic Cooperation and Development

“A revenue-neutral growth-oriented tax reform would be to shift part of the revenue base towards recurrent property and consumption taxes and away from income taxes, especially corporate taxes. There is also evidence of a negative relationship between the progressivity of personal income taxes and growth.”

Source: “Do tax structures affect aggregate economic growth? Empirical evidence from a panel of OECD countries.” (2008)

State Personal Income Tax Burden Rankings

<u>State</u>	<u>Per Capita Burden</u>	<u>Rank</u>
□ California	\$1,346	6 th
□ Colorado	\$893	20 th
□ Utah	\$822	23 rd
□ New Mexico	\$514	39 th
□ Arizona	\$444	41 st

Source: US Census Bureau; Tax Foundation

Income Tax and Percentage of Total Revenue

California	26.4%
Utah	25.3%
Colorado	20%
New Mexico	14.6%
Arizona	12.3%

Note: Total revenue as defined by the Census Bureau, which includes general fund revenue as well as all other state-generated revenue sources.

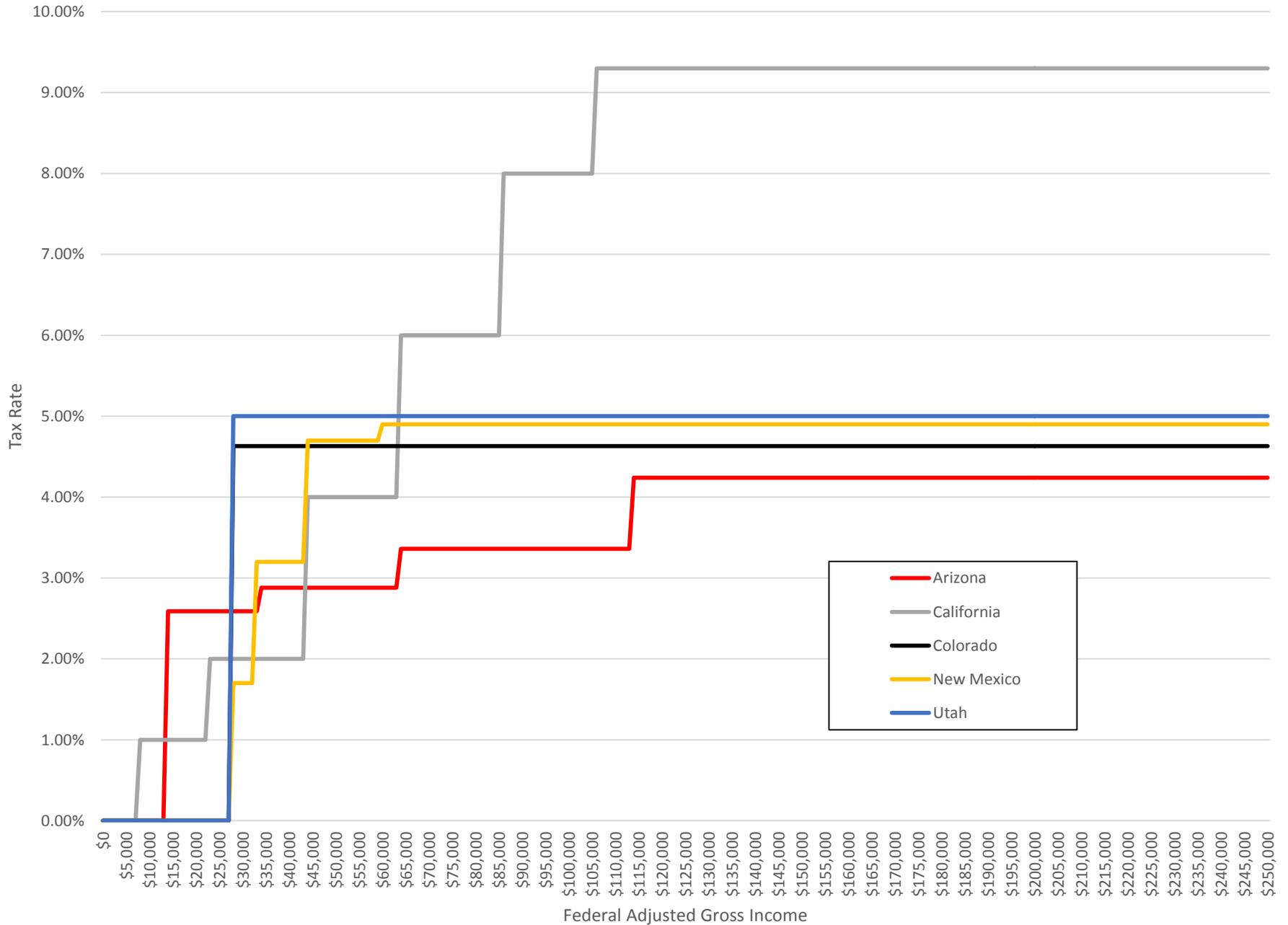
Source: US Census Bureau.

Tax Foundation Business Tax Climate Index

Personal Income Tax Ranking

Utah	14 th
Colorado	16 th
Arizona	17 th
New Mexico	34 th
California	49 th

Statutory Tax Rates for a Family of Four



Rates, Exemption, and Deductions

	Standard Deduction (joint)	Personal Exemption	# of Brackets	Top Income Tax Rate
Arizona	\$9,406	\$2,100	5	4.54%
California	\$7,682	\$102*	10	13.3%
Colorado	\$11,900	\$3,800	1	4.63%
New Mexico	\$11,900	\$3,800	4	4.9%
Utah	\$11,900	\$3,800	1	5%

Note: Number of brackets does not include “zero bracket.”

* - Tax credit

Common Attributes

All states in the region:

- Use Federal Adjusted Gross Income as the starting point
- Tax S-corps and “pass through entities” via the personal income tax code

Capital Gains Tax Rate

Arizona	3.4%
California	13.3%
Colorado	4.6%
New Mexico	2.5%
Utah	5.0%

“Instant Expensing” (Section 179)

Arizona	Yes
California	No
Colorado	Yes
New Mexico	Yes
Utah	Yes

Inflation Indexing

	Brackets	Standard Deduction	Personal Exemption
Arizona	No	Yes	No
California	Yes	Yes	Yes
Colorado	n.a.	Yes	Yes
New Mexico	No	Yes	Yes
Utah	n.a.	Yes	Yes

Note: Number of brackets does not include “zero bracket.”

* - Tax credit

Conclusions

- ❑ Income taxes, by nature, inhibit economic growth and potential.
- ❑ Flat income taxes are preferable to graduated-rate income taxes. Absence of an income tax is preferable to either.
- ❑ Other states are beginning to move faster on tax reform than Arizona.