INSTITUTE FOR REFORMING GOVERNMENT

Growing Economic Prosperity – Lessons from Tax Reforms in the States

Executive Summary

"Government does not tax to get the money it needs; government always finds a need for the money it gets." ~ President Ronald Reagan.

While tax revenues are necessary for providing the core responsibilities of government, elected leaders must ensure they derive from appropriate sources that are fair to those paying them. States often are called "laboratories of democracy," as they can experiment with policies with greater flexibility and responsiveness than the federal government. This certainly is true with tax policies. Taxes have a direct and critical impact upon the future of each individual, family, and job creator in the state. Many states have enacted tax policies that should be shared and considered by other states, while some have resulted in poor results that should be avoided by others. The non-partisan think tank, Tax Foundation, suggests four principles of sound, fair tax policy: (1) simplicity, (2) transparency, (3) neutrality, and (4) stability. The examples included in this report showcase these four tenets and describe various paths to meaningful reform. They are intended to illuminate policy debates around state tax reform and help inspire leadership for sustained, economic growth.

Recommendations

To inspire this growth, below are four recommendations that are a result of the policy analysis in the report. These recommendations reflect the mission of the Institute for Reforming Government which seeks to simplify government at every level by offering policy solutions to thought leaders in American government in the areas of tax reform, government inefficiency, and burdensome regulations. We believe by working toward implementing these types of pro-growth policies state governments will see higher economic growth and job creation that benefits working families.

1. Enact taxpayer controls that put more decision making directly into the hands of taxpayers to approve spending or other policy changes, before lawmakers are able to increase taxes. This would help:
   - Provide much greater transparency to taxpayers.
   - Restrain government spending and keep governing bodies in check by the people who elected them.
   - Increase economic growth leading to taxpayers keeping more of their hard-earned money.
   - Limit increases by having parameters set by taxpayers, not lawmakers.
2. Ease the taxpayer's burden of compliance by making tax laws simpler through fewer tax brackets and reduced steps in calculating the total tax bill. This would help:
   - Give taxpayers more opportunity to save their own hard-earned dollars through lower taxes and simpler tax laws.
3. Reduce tax rates on personal income and business income. This would help:
   - Contribute to bottom-up and top-down economic growth, which benefits everyone.
   - Inspire job creation and ease the tax burden for working families.
4. Broaden the tax base. This would help:
   - Lower tax rates so that Americans can keep more of what they earn.

- Contribute to growth and build revenue.
- Level the playing field among businesses and job creators while facilitating the collection of tax revenue.
- Minimize preferential treatment in the tax code.

The report provides substantive support for these recommendations and illustrates the need for tax reform around the country.

In Wisconsin steadfast leadership maintained a deep commitment to reducing taxes and, over a period of eight years, reduced taxes in the Badger State by $8 billion. Year after year, Governor Scott Walker and the legislature hammered away at the tax burden by lowering income tax rates and slashing property taxes. In 2018, Wisconsin's property tax rates were lower than they were eight years earlier, while home values had risen. Lower taxes also spurred economic growth as real GDP in the state grew two times faster than the previous decade, moving Wisconsin from 35th to 11th in the nation for the fastest growth.

While less common, major tax reform can be achieved in a single legislative session when state fiscal policy and political climates are aligned. In 2013, North Carolina implemented a bold makeover of its tax structure by consolidating the three individual income tax brackets into one, flat tax rate of 5.8%, a reduction of each tax bracket. Income taxes paid by job creators also were reduced, but inefficient tax credits historically provided to certain activities were repealed. Income tax rates were further reduced over the next 6 years, but, within two years after the 2013 reforms, the Tar Heel State led the nation in real GDP growth at a record 13.4% increase and was named by *Forbes* as the second, best state for business in the nation.

The pinnacle for many tax reformers has been the complete elimination of the individual income tax. Seven states[1] have no individual income tax, but Alaska is the only state to have repealed an existing individual income tax. The others have never had the tax. States without the individual income tax are highly attractive to families fleeing high tax states. Naturally, eliminating the individual income tax denies a state a significant portion of state revenues, and finding replacement revenues often proves too difficult for states considering a repeal.

Sustainable reforms should include a broadened tax base that parallels tax reductions. Kansas failed to make this match in 2012, when it slashed income rates but never eliminated certain deductions and other tax breaks. Instead, the tax cut was projected to have an annual cost of over $800 million. As a result, the state faced significant budget cuts, financial distress, and, ultimately, several tax increases to reverse the 2012 reductions.

Tax reforms always are subject to being rolled back when state government perceives the need for more spending. Making reforms more permanent was the goal of Colorado taxpayers in 1992 when voters approved an amendment to the state constitution called the Taxpayers Bill of Rights (TABOR). Enshrined in the constitution, TABOR prevents state or local governments from raising taxes without voter approval and caps state spending of tax revenues if revenues outpace inflation and population growth. Revenues that exceed this formulized cap are returned to the taxpayers through avenues determined by the legislature. While TABOR has returned $3.5 billion in tax revenues to the taxpayers over 25 years, it remains under attack by the "tax and spend lobby." A referendum on the 2019 ballot seeks to loosen the cap so that excess funds can be spent on education and infrastructure desires, and signatures are being collected for a measure on the 2020 ballot that would wholly repeal TABOR.

[1] Tennessee and New Hampshire only tax dividend and interest income under an individual tax rate. Tennessee passed legislation in 2016 that will phase down this tax and completely eliminate it in 2021.

Utah also maintains a tax limiting law that provides stability and transparency for property taxes. Passed in 1985, the Truth in Taxation law prescribes a process that local governments must follow to increase property taxes. Public notices, a delineation of the dollar amount of a proposed increase, and a public meeting are all components of the law that keeps local government spending in check. In a 22-year period, the property tax burden in Utah has been one of the most stable in the nation. Revenues from property taxes have increased at an average, annual rate of 4% since the law was passed; compared to 12% before 1985.

These examples are noteworthy and provide a broad spectrum of substantive policy and the processes for achieving the reforms. The full report provides a more detailed illustration of these examples and citations for further research.