Legislators should consider new revenue options for addressing state budget shortfall

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Arizona Center for Economic Progress

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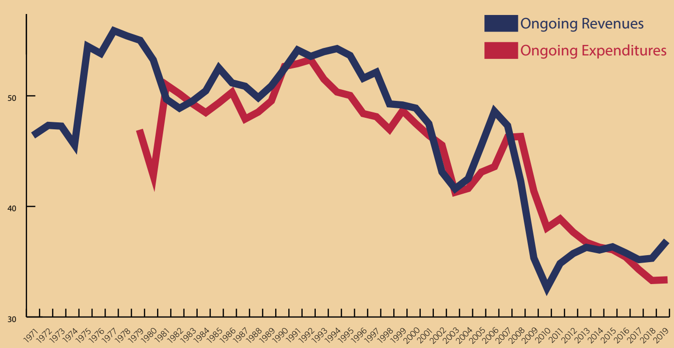
The Arizona legislature has cut taxes every year but one since 1990 and all of those tax cuts combined have reduced state revenues by more than $5 billion when adjusted for inflation. Many of those tax cuts over the years have not gone to everyday Arizonans but instead have benefitted corporations and the wealthiest Arizonans. Proponents of those tax cuts often proclaimed that the tax breaks were needed to bring more jobs and economic growth to our state. But if the COVID-19 crisis has taught us anything, it is that economic growth is driven by everyday people – not by corporations and the wealthy. The more people are spending money in stores and restaurants, going on vacations and supporting small businesses, the more jobs and economic growth they are creating. Instead of more tax cuts, lawmakers should pursue strategies that will provide Arizonans with opportunities to increase their earning capacity through educational attainment, by improving their job skills, or by removing barriers that make it difficult for people to participate in the workforce, including barriers like the lack of affordable childcare or stable affordable housing. Arizona once did a much better job of addressing these issues by investing more, but three decades of annual tax cuts have steadily reduced state revenues – disinvestment from the very things that could create a more skilled workforce and a stronger economy.

Three Decades of Declining Revenues and Disinvestments

Ongoing Revenues and Expenditures Per $1,000 of Personal Income Arizona State Government General Fund



Source: Tabulations prepared by Tom Rex, Associate Director, Center for Competitiveness and Proseperity Research, Arizona State University, based on data from the Joint Legislative Budget Committee staff, Appropriations Report, various years and the U.S. Department fo Commerce, Bureau of Economic Analysis.

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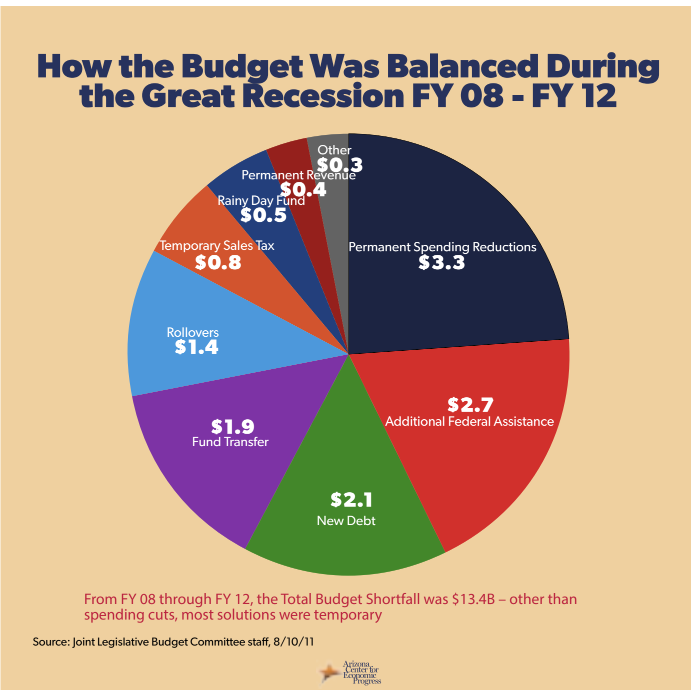
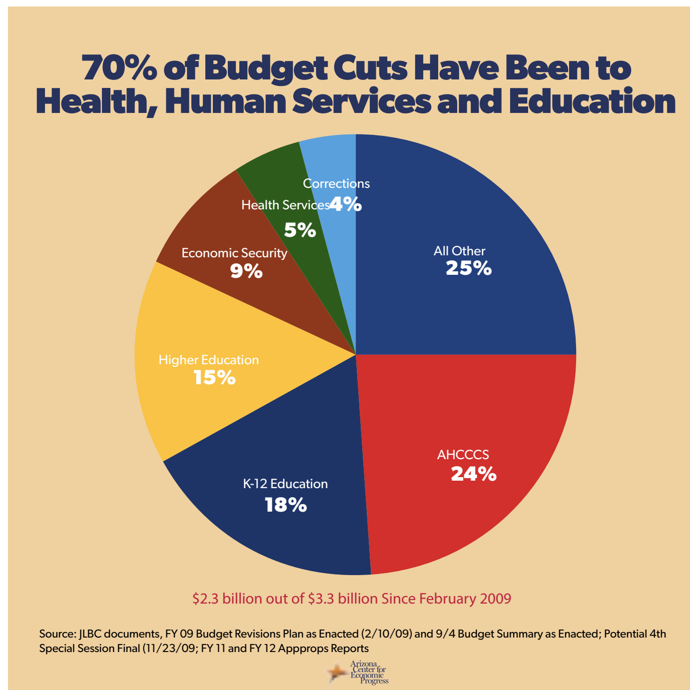
Arizona Faces Significant State Budget Shortfalls

COVID-19 has brought about an economic crisis that some economists fear could be worse than the Great Recession. The non-partisan Joint Legislative Budget Committee has forecasted a $1.1 billion revenue shortfall for the state budget for the current and coming fiscal years combined. While Arizona does have $945 million in its Rainy Day Fund, those savings will quickly disappear if, as many expect, the budget shortfall is even larger for the second fiscal year which begins July 2021. In addition, demand for some public services increases during economic downturns as many struggle with financial hardships and that demand further strains state program budgets. As state lawmakers begin to grapple with this current COVID-19 economic crisis, we urge them to take a different approach from how lawmakers chose to deal with the state budget shortfall during the Great Recession.

During the Great Recession, lawmakers addressed the state budget shortfall with massive budget cuts, fund sweeps and budgeting gimmicks while at the same time reducing state revenues even further by continuing to cut taxes. For example, in 2011, while the Arizona legislature was in the midst of passing the largest funding cuts in the nation to public education and our universities, lawmakers also passed the largest corporate tax cuts in state history.[1] The impact of the state budget cuts from the Great Recession are still being felt today. For example, per pupil funding for public education is 48th in the nation and tuition at our state universities has risen faster than any other state.[2] Arizona needs a better approach to get out of this economic crisis. Cutting education, universities, housing and more while at the same time giving tax breaks to the wealthy and well-connected is what Arizona has been doing for 30 years. Communities of color, low-income communities, and rural Arizona have borne the brunt of this approach by cutting public services that provide them with a path toward better economic opportunities. Going back to the way things have normally been done is not good enough – we need to emerge from this crisis ready to build the Arizona we all deserve.

Arizona has one of the most regressive tax codes in the nation with low- and middle-income households paying a larger portion of their income in state and local taxes than do wealthier taxpayers. The federal government also recently cut taxes sharply for corporations and the wealthy. The 2017 federal tax cuts reduced the federal corporate tax rate from 35 percent to 21 percent. In addition, the top 1 percent of individual income tax earners in Arizona received an average federal tax cut of $43,970 compared to what they paid two years ago.





Reverse corporate income tax rate cuts

In 2011, the state legislature passed the largest corporate tax cuts in state history. Among those cuts was a reduction in the corporate income tax rate from 6.968 percent to the current 4.9 percent. Raising the corporate income tax rate to a level that would still be low compared to most other states is a reasonable solution that would raise needed revenue and make Arizona's tax code fairer. Returning the state corporate income tax rate to 6 percent would produce an estimated $79 million in annual revenue and Arizona would still have a lower corporate income tax rate than 29 other states.

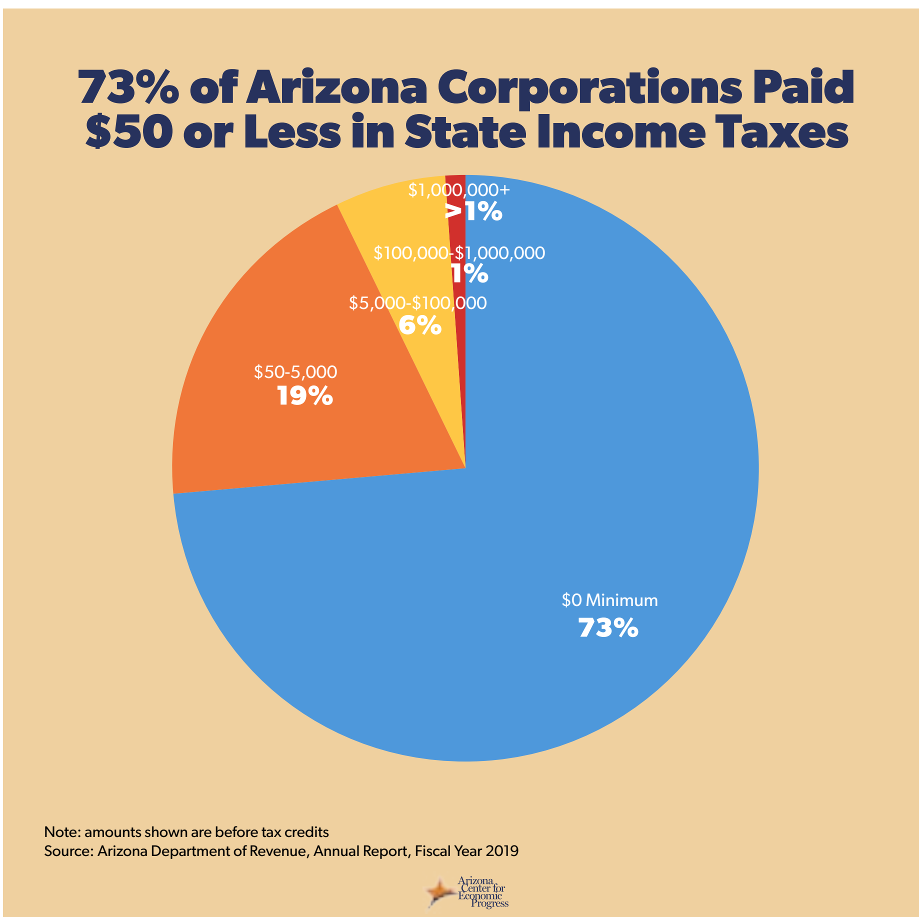
[1] "State's corporate tax cuts not proving to be economic stimulus," Howard Fischer, Capitol Media Services, April 13, 2016
[2] 2018 Annual Survey of School System Finances, U.S. Census Bureau
[3] "Who Pays?," Institute on Taxation and Economic Policy, October 2018
[4] Institute on Taxation and Economic Policy

Make multistate corporations pay their fair share

Many corporations have facilities and employees in Arizona but their products are largely shipped and sold out of state. While these companies pay little tax, they receive public benefits in the form of roads and infrastructure to support their facilities and from public schools, universities and other community services to support their workforce. By contrast, other corporations might not have any facilities or employees based in Arizona, but they sell a significant portion of their products in our state. These corporations that do not have facilities or workers in Arizona but which are selling their products in our state receive benefits in the form of the state providing a market for their products, while also paying little tax. Even though these corporations have different types of presence in Arizona, both types receive benefits from state services that they should pay taxes to support. Yet, Arizona's method of calculating how much of a multistate corporation's nationwide profit is taxable in Arizona results in many corporations not paying their fair share of state income taxes.

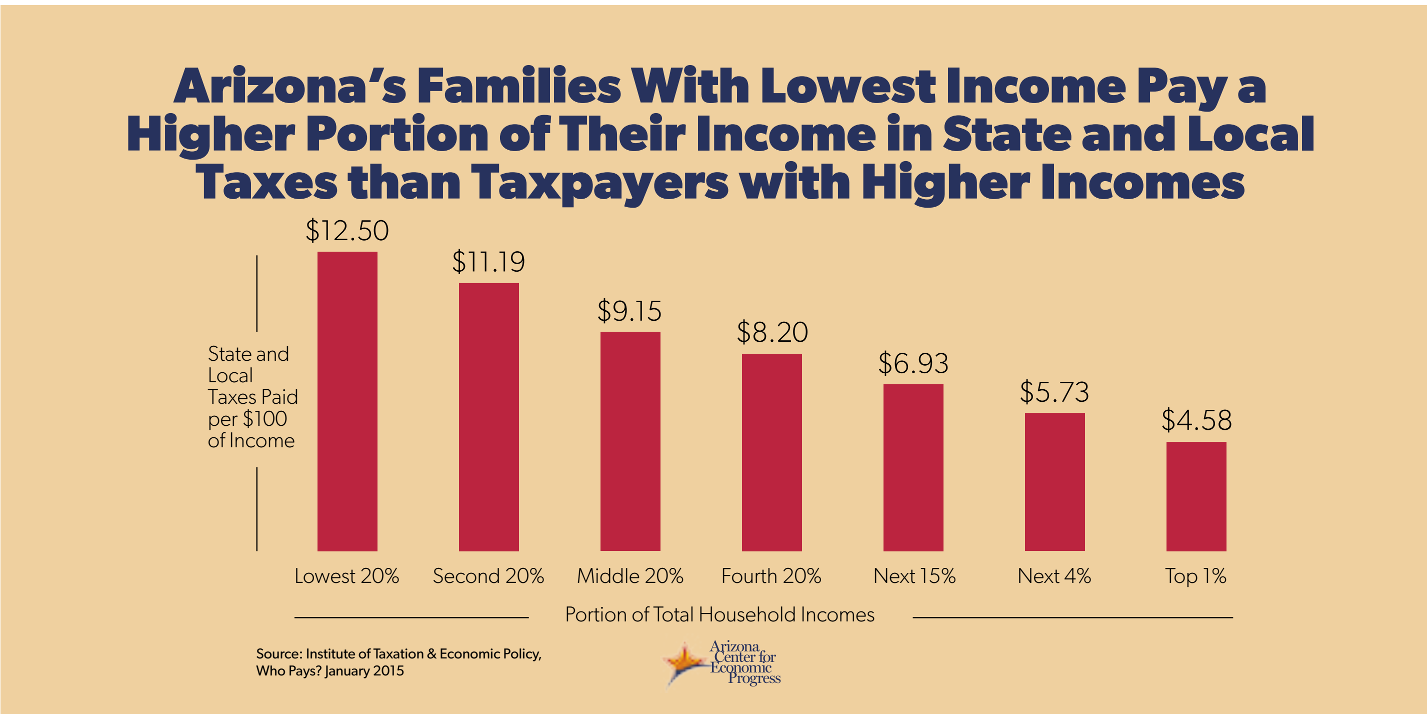
For many years, Arizona determined the portion of a multistate corporation's profit that was subject to tax in Arizona by using a formula that equally weighed the shares of the corporation's total property, payroll, and sales located in our state. However, since 2011 Arizona has been one of only two states in the nation to allow multistate corporations to choose between two different formulas: one formula weighs the share of property, payroll and sales; and the other formula only weighs the share of sales in Arizona. Giving corporations the option to choose between two formulas means they generally choose the formula that allows them to pay the least and it results in corporations not paying their fair share for the state services they receive to support their business.

By returning to a formula that equally weighs the percentage of a corporations property, payroll and sales in the state, Arizona could raise an additional $114 million in revenue annually and take a big step forward in ensuring that all corporations are paying their fair share for the public services their businesses use and depend upon.



Repeal 2014 capital gains tax cut

Capital gains are the profits an investor realizes when selling an asset that has grown in value, such as the shares of stock, mutual funds, real estate or artwork. Capital gains, which go overwhelmingly to the wealthiest households, receive special tax preferences in Arizona. By state law, the profits on anything held for less than a year are taxed as regular income. But in 2012, State lawmakers approved a measure to allow long-term gains – investments held for more than a year – to be provided a 25 percent discount when computing state income tax liability. For example, an Arizona taxpayer who makes $100,000 in profit from the sale of stocks would only be taxed on $75,000 of that profit. An analysis of this tax break showed that 83 percent of the benefits from this tax cut went to the top 5 percent of wealthiest incomes in Arizona, those earning more than $250,000 per year.[5] Reversing this tax break would produce $116 million in annual revenue.



Conclusion

Collectively, the three tax changes outlined in this report are reasonable and effective options for raising an estimated $309 million in new revenue annually. New revenues which will help Arizona address budget shortfalls without the harmful cuts to funding for our public schools, healthcare, supports for affordable housing, childcare, and other resources all Arizonans depend on for a stronger economy and thriving communities.

[5] Institute on Taxation and Economic Policy