INSTITUTE ON TAXATION AND ECONOMIC POLICY

Informing the debate over tax policy nationwide

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Four Tax Ideas for Jobs-Focused Governors

As the nation's governors gather in Williamsburg, Virginia this week, their focus is on their Chairman's initiative, ***Growing State Economies.*** Too often, however, a governor's knee-jerk response to a lagging economy is to start cutting taxes, even though state tax cuts offer a demonstrably low economic bang-for-the-buck, for a number of reasons.[1] Since most states are required to balance their budgets every year, any tax cut requires an offsetting cut in state services, which acts as a drag on economic growth. Moreover, tax cuts at the top of the income ladder (as opposed to the bottom) are particularly ill-suited to boosting consumer demand, yet this is where the bulk of many recent tax cut plans have been targeted. Finally, many state tax cuts actually result in federal tax *hikes* for those same taxpayers, causing millions of dollars to flow out of the state as taxpayers watch their federal tax deductions shrink. [2]

Tax cuts aren't the economic panacea that is often claimed, but there are ways in which governors can reform their states' tax codes to pave the way for improved economic performance. Four such options are described below, along with some brief notes about current governors from both parties that have accepted or shunned these valuable policy options.

Option 1: Create infrastructure jobs by raising gasoline and diesel taxes.

State gas taxes are the single most important source of transportation revenue under the control of state lawmakers. But most state gas taxes are generating far too little revenue, squeezed by the rising cost of transportation construction, and the growing fuel-efficiency of vehicles on the road today.

Raising state gas taxes to deal with these challenges, and using the revenue to fund infrastructure maintenance and improvements, is a surefire way to spur economic growth. Such a reform would result not only in more construction industry jobs, but also in improved efficiencies for every business that relies on the transportation network for the movement of its products and employees. For these reasons, business groups including the U.S. Chamber of Commerce are often among the most vocal proponents of raising gas taxes.

Governors Leading the Way:

- **Martin O'Malley (MD)** repeatedly advocated raising the state's gas tax during the 2012 legislative session, and allowing the tax to grow in future years alongside the price of gas.

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[1] For a rebuttal to some recent claims about the enormous economic benefits of tax cuts, see: http://www.itep.org/DebunkingLaffer/

[2] http://www.itep.org/pdf/pb7off.pdf

- **Rick Snyder (MI)** urged raising additional revenue for transportation through a variety of means during the 2012 legislative session, including by allowing the gas tax to gradually rise over time alongside the price of gas.

- **Terry Branstad (IA)** has been clear about his plans to push for a gas tax increase in 2013, saying that "next year's the year to do it."[3]

Governors Headed in the Wrong Direction:

- **Dan Malloy (CT)** recently made his state's gas tax much less sustainable by signing a bill during the 2012 session that caps the gas tax rate in order to stop it from growing over time.

- **Paul LePage (ME)** signed a gas tax cap, similar to Connecticut's, in 2011 that will make it much more difficult for the state to raise adequate transportation revenues in the years to come.

- **Beverly Perdue (NC)** proposed a gas tax cap in her most recent budget, though she has yet to sign such a cap into law.

For more information, follow the links below:

- ***Building a Better Gas Tax***
- ***State Gasoline Taxes: Built to Fail, But Fixable***

Option 2: Level the playing field for local retailers by enforcing sales tax laws on online shopping.

It's a basic matter of fairness that state sales taxes should be applied to the things we buy, regardless of whether a purchase is made online or in a brick-and-mortar store. But it's also an issue of economic competitiveness. Traditional retailers with a significant in-state presence have long suffered as a result of consumers' ability to evade sales taxes by shopping online. This tax enforcement nightmare has given out-of-state "e-retailers" an unfair advantage over their local competitors, but state lawmakers do have options for leveling the playing field for local businesses.

Specifically, governors and state legislators can chip away at this problem by: expanding the scope of retailers subject to sales tax collection requirements, striking agreements with companies like Amazon.com to begin collecting sales taxes as soon as possible, and lobbying the federal government to enact a comprehensive solution to this problem. Until the federal government acts, states won't be able to apply their sales tax collection laws to all out-of-state businesses, but taking these steps can at least keep state policy moving in the right direction.

Governors Leading the Way:

- **A number of states** have enacted laws that expand the universe of online retailers required to collect and remit state sales taxes. Those reforms have been enacted under the leadership of governors **Mike Beebe (AR), Jerry Brown (CA), Dan Malloy (CT), Nathan Deal (GA), Pat Quinn (IL), Beverly Perdue (NC), and Tom Corbett (PA).**

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[3] http://www.radioiowa.com/2012/05/18/governor-next-years-the-year-to-raise-state-gas-tax/

- **Many states** have recently reached agreements with Amazon.com, the world's largest online retailer, to begin collecting sales taxes within the next few years. These deals were struck under the leadership of current governors **Mitch Daniels (IN), Brian Sandoval (NV), Chris Christie (NJ), Bill Haslam (TN), and Bob McDonnell (VA).**

- **Numerous governors** have announced their support for federal legislation empowering the states to enforce their sales tax laws. **Terry Branstad (IA), Mitch Daniels (IN), Paul LePage (ME), Rick Snyder (MI), Chris Christie (NJ), and Bill Haslam (TN)** fall into this category, to name just a few.

Governors Headed in the Wrong Direction:

- **While Texas** recently succeeded in requiring Amazon.com to collect sales taxes on purchases made by Texans, **Rick Perry (TX)** fought that effort nearly every step of the way. Perry vetoed a 2011 bill aimed at requiring more online retailers to collect the tax, and was an outspoken critic of the state Comptroller's efforts to require that Amazon begin collecting sales taxes. [4]

For more information, follow the links below:

- ***How Can States Collect Taxes Owed on Internet Sales?***
- ***New York's "Amazon Law": An Important Tool for Collecting Taxes Owed on Internet Purchases***

Option 3: Scrutinize special tax breaks to root out wasteful giveaways.

States are spending untold billions on special tax breaks, or "tax expenditures," that are claimed to steer businesses to behave in ways that lead to economic growth. Unfortunately, most states have done nothing even remotely rigorous to determine whether these breaks—many of which have been on the books for decades—are worth their cost. By allowing tax breaks of dubious merit to continue year after year, states are forced to forgo spending on more effective programs, or to raise taxes on ordinary families to fill the resulting revenue gap.

Carefully evaluating the effectiveness of special tax breaks in achieving their intended goals allows lawmakers to make informed decisions about which tax breaks should be restructured to improve their effectiveness, and which should be eliminated to free up budgetary resources for higher-priority projects.

Governors Leading the Way:

- **Martin O'Malley (MD)** signed legislation in 2012 requiring expert evaluations of nine different tax credits, as well as legislative review of those evaluations.

- **Bob McDonnell (VA)** signed legislation in 2012 that sets up a legislative process for evaluating tax breaks, and requires that new tax breaks sunset after five years so that lawmakers can reconsider and vote on those breaks in light of new evidence of their effectiveness.

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[4] See http://www.statesman.com/news/texas-politics/perry-vetoes-online-sales-tax-bill-but-measure-1510450.html and http://www.dallasnews.com/business/headlines/20110211-texas-gov.-rick-perry-says-he-wouldnt-have-pursued-amazon.com-sales-taxes.ece

- **John Kitzhaber (OR)** signed legislation during the 2011 session that significantly scaled back a number of tax credits, after those credits were carefully scrutinized by the Joint Committee on Tax Credits.

Governors Headed in the Wrong Direction:

- **A number of states** have legal requirements that tax breaks be evaluated for their effectiveness, but those requirements have not been adequately enforced under the leadership of governors **Jack Markell (DE), Bobby Jindal (LA), Dave Heineman (NE), Chris Christie (NJ), and Scott Walker (WI).**

For more information, follow the links below:

- ***Tax Expenditures: Spending By Another Name***
- ***How to Enact (and Maintain) Tax Reform***
- ***Judging Tax Expenditures***
- ***Evidence Counts***

Option 4: If tax cuts are a priority, target them toward low-income families to maximize their impact.

As mentioned earlier in this brief, state tax cuts are generally of limited economic benefit to state economies, in part because tax cuts are often saved rather than spent, and because many state tax cuts result in significant federal tax hikes. Tax cuts targeted specifically at low-income families, however, are the exception to this rule. Low-income families are likely to spend most or all of any tax cut they receive just to make ends meet. And very few low-income taxpayers claim itemized deductions on their federal tax returns, and are therefore not at risk of seeing a federal tax hike if their state tax bills are reduced.

Governors Leading the Way:

- **Dan Malloy (CT)** championed legislation in 2011 creating a refundable state Earned Income Tax Credit (EITC) equal to 30 percent of the federal credit.

Governors Headed in the Wrong Direction:

- **Sam Brownback (KS)** signed legislation in 2012 that cuts taxes for every income group except the poorest 20 percent of Kansas residents. The state's poorest taxpayers will actually see their taxes rise as a result of the Food Sales Tax Rebate, Child and Dependent Care Credit, and the Homestead Property Tax Refund for renters all being eliminated.[5]

- **Mary Fallin (OK)** pushed for a tax cut in 2012 that was broadly similar to that signed by Gov. Brownback in Kansas, though her efforts ultimately met with failure. Her plan would have cut taxes steeply at the top while actually raising taxes on the low-income families that benefit most from the tax credits she targeted for elimination. [6]

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[5] http://itep.org/pdf/pb10cb.pdf

[6] http://okpolicy.org/files/Bait-and-Switch.pdf

- **Rick Snyder (MI)** signed legislation in 2011 that cut taxes steeply for businesses, and paid for those cuts with significant tax hikes on individuals. The largest tax hikes were reserved for the state's poorest residents, due mostly to a sharp reduction in the state's EITC. [7]

- **Jan Brewer (AZ)** and **Butch Otter (ID)** each enacted personal income tax cuts in 2012, reserved exclusively for the best-off taxpayers in their states. Brewer signed a capital gains tax cut into law, while Otter signed a tax rate reduction benefiting only the richest fifth of all Idaho families. [8]

- **Chris Christie (NJ)** signed a bill in 2010 cutting the state's EITC, and has offered to reverse that cut only if a much larger and more poorly targeted tax cut is also enacted.

- **Pat Quinn (IL)** recently oversaw the elimination of the state's property tax "circuit breaker," a 40-year old program designed to help low-income seniors and the disabled pay their property tax bills.

- **Rather than targeting relief** to the state's lowest-income families, **Mitch Daniels (IN) and Bill Haslam (TN)** each cut taxes for lucky heirs and heiresses by signing bills repealing their states' inheritance taxes. **Dave Heineman (NE)** unsuccessfully attempted to eliminate his state's inheritance tax as well.

For more information, follow the links below:

- ***State Tax Codes as Poverty Fighting Tools***
- ***Rewarding Work Through Earned Income Tax Credits***
- ***Reducing the Cost of Child Care Through Income Tax Credits***
- ***Options for Progressive Sales Tax Relief***
- ***Property Tax Circuit Breakers***

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[7] http://www.milhs.org/wp-content/uploads/2010/07/TaxChangesHitLowIncomeFamiliestheHardest.pdf

[8] http://www.itep.org/pdf/IdahoAnalysis.pdf