State Tax Update: August 2011
(preliminary report)

NATIONAL CONFERENCE *of* STATE LEGISLATURES

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National Conference of State Legislatures
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The National Conference of State Legislatures is the bipartisan organization that serves the legislators and staffs of the states, commonwealths and territories.

NCSL provides research, technical assistance and opportunities for policymakers to exchange ideas on the most pressing state issues and is an effective and respected advocate for the interests of the states in the American federal system.

NCSL has three objectives:

- To improve the quality and effectiveness of state legislatures.
- To promote policy innovation and communication among state legislatures.
- To ensure state legislatures a strong, cohesive voice in the federal system.

The Conference operates from offices in Denver, Colorado, and Washington, D.C.

Printed on recycled paper

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For the first time in 10 years, states cut taxes more than they increased them. But readers should not draw hasty conclusions about what this means for states' fiscal health. Most states continued to face substantial budget shortfalls during their 2011 legislative sessions, even though some states saw revenue collections increase. The net state tax reduction is a result of temporary tax increases expiring in a handful of states. Removing the impact of those temporary taxes from the mix, states enacted a net tax increase of $9 billion. But again, this is misleading because large tax increases in only two states accounted for nearly all of the gains. In short, the aggregate figures are skewed by a handful of states where tax increases and tax cuts were large and extensive.

All 50 states have provided NCSL with data about tax changes made in 2011, which largely affect revenue collections in fiscal year (FY) 2012.

State actions result in a net tax decrease of nearly $2.5 billion, representing 0.4 percent of total state tax collections. Nine states reduced net taxes by more than 1 percent, while an equal number reported net tax increases greater than 1 percent[1]. Thirty-two states made no significant changes to tax policy.

Sales taxes experienced the largest cuts, at what was projected to be more than $5.2 billion. This is primarily due to the expiration of temporary sales tax increases in California and North Carolina. States also cut corporate income taxes and miscellaneous taxes. Many of these reductions were also the result of allowing temporary tax increases to expire.

States as a whole raised taxes in all other categories. Personal income taxes saw the largest expected net increase, nearly $2.5 billion, mostly explained by a rate increase in Illinois that is expected to generate $6.5 billion. Several states let temporary income tax rate increases expire, resulting in substantial reductions that offset tax increases in other states. The health care category recorded the second largest tax increase. New assessments on health care providers in a number of states are expected to generate in $1.9 billion in additional revenues.

Three trends emerged in 2011:

- States allowed temporary taxes to expire, many of which were approved in 2009 for two years.

[1] The nine states with net tax cuts greater than 1 percent are California, Iowa, Maine, Michigan, New York, North Carolina, North Dakota, Ohio and West Virginia. The nine states with net increases of more than 1 percent are Connecticut, Hawaii, Illinois, Indiana, Maryland, Nevada, Oklahoma, Oregon and Vermont.

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- States focused on reforming or reducing business taxes.
- To help cover rising Medicaid costs, states raised health care provider taxes.

While not rising to the level of trends, a few other tax actions were common. As in past years, several states broadened their tax bases by reducing credits and exemptions in various categories. Policymakers also continued to search for new sources of revenue by targeting digital and on-line sales. Others focused on tax policies designed to jump-start local economies with new incentives to create jobs and develop small businesses. Lastly, some states examined the estate tax with renewed interest.

States also generated new revenues through fees, accelerations and other nontax actions, activity in this category has been much lower than in past years. In addition, a few states adopted new compliance measures and at least three states authorized tax amnesty programs.

Personal Income Taxes (net increase: $2,478 million)

Six states increased personal income taxes; however, rate increases in just three of them accounted for nearly $8 billion in anticipated new revenue. Likewise, while 21 states cut personal income taxes, reductions in only four states accounted for an expected loss of more than $8 billion in FY 2012.

State tax increases include:

- Illinois raised the personal income tax rate from 3 percent to 5 percent, in January 2011, which is expected to generate more than $6.5 billion in additional revenue.
- Connecticut expects to raise more than $893 million by increasing marginal tax rates and phasing out the lowest tax bracket for taxpayers over a new income threshold.
- Michigan lawmakers restructured taxes to raise more revenue from personal income taxes while reducing business taxes. The change imposes income tax on pensions and retirement income, eliminates special exemptions for seniors and children and eliminates most income tax credits, including the property tax credit and the earned income tax credit (EITC).

Other states reduced income tax:

- California lawmakers allowed a temporary 0.25 percent income tax increase to expire, resulting in a projected revenue loss of $1.3 billion. In addition, a reduction in the dependent care credit expired, for an additional $1.3 billion reduction in revenue.
- New York's temporary income tax surcharge on high-income taxpayers will expire in December 2011, resulting in an anticipated revenue loss of more than $1.7 billion.
- North Carolina lawmakers let a temporary income surtax expire.

- Delaware reduced the top income tax bracket (on taxpayers earning more than $60,000 a year) by 3 percent. That rate was raised in 2009 to help close the budget shortfall and was set to expire in 2014.
- Ohio legislators cut more than $519 million by resuming a previously legislated phase down of the personal income tax rate that was suspended in 2010.
- Maryland let a temporary income tax increase—adopted in 2008 on incomes over $1 million—expire for a projected revenue loss of $55 million.
- North Dakota cut the personal income tax rate from 4.80 percent to 3.99 percent.
- Maine lawmakers adopted legislation that consolidates the current personal income tax brackets and reduces the rate for the highest income bracket from 8.5 percent to 7.95 percent. Changes will become effective in 2013.
- Arizona expanded an existing income tax credit for investments in qualified small businesses.
- Nebraska approved a credit for "angel investors" who invest in new businesses.
- Wisconsin provided a personal income tax deferral for capital gains income if the money is reinvested in a qualified Wisconsin-based business within 180 days.
- Wisconsin also resumed phasing in deductions for child care costs and health insurance premiums, which were delayed in 2009 for two years.
- Indiana approved a new income tax deduction for unreimbursed private and home school expenditures equal to $1,000 per child.
- Connecticut and Iowa increased their state earned income tax credits (EITC) for the working poor.
- Iowa exempted active duty military pay from state income taxes.

Corporation and Business Taxes (net decrease: $807 million)

Lawmakers in many states focused on reducing business taxes during the 2011 legislative session. As a result, 20 states cut corporate taxes. Eight raised them.

Business tax cuts include:

- Michigan cut business taxes by more than $1 billion as part of a major tax restructuring measure. Lawmakers eliminated the Michigan Business Tax and replaced it with a 6 percent corporate income tax with no credits, except for small businesses.
- Lawmakers in Delaware approved three separate business tax cuts: the gross receipts tax (across the board by 3 percent), the bank franchise tax, and the gas and electric utility tax.
- North Dakota reduced the corporate income tax rate by 19.5 percent and reduced the tax rate for financial institutions by 7.1 percent.

- Lawmakers in Indiana voted to phase-in a corporate income tax cut. The rate will be reduced from the current rate of 8.5 percent to 8.0 percent in FY 2013; 7.5 percent in FY 2014; 7.0 percent in FY 2015 and 6.5 percent in FY 2016 and thereafter.
- Florida raised the corporate income tax standard exemption from $5,000 to $25,000 and increased research and development credits.
- Arizona will reduce the corporate income tax rate over four years from 6.968 percent to 4.9 percent. The revenue loss will first occur in FY 2015 and is estimated to be more than $53 million, increasing to a loss of $269.6 million by the time the cut is fully implemented in FY 2018.
- Lawmakers in Maine created a non-refundable corporate income tax credit(known as the Maine capital investment credit), which is equal to 10 percent of the federal bonus depreciation.
- New Jersey adopted a single sales factor apportionment formula that is expected to reduce revenue by $24 million.
- New Hampshire policymakers reduced the state's business profits tax.
- Maryland and Utah raised tax credits for film production, while Oregon extended its credits for another five years.
- Arizona created a new jobs tax credit, and Oklahoma reinstated a corporate tax credit for aerospace employment.
- Virginia approved a number of new credits including ones for ports, research and development, and tele-work expenses.
- West Virginia raised the aggregate tax credit cap for neighborhood investment to $3 million annually.
- Wisconsin approved a number of economic development measures including corporate income tax deductions for hiring new full-time employees.

Other states increased business taxes:

- Illinois lawmakers approved a temporary corporate income tax increase. The rate went from 4.8 percent to 7 percent for four years and is expected to generate $780 million. They also suspended the deduction for net operating losses for three years to raise an additional $312 million.
- Connecticut extended the temporary corporate income tax surcharge for two years and doubled the rate from 10 percent to 20 percent.
- The Nevada legislature extended several temporary business taxes for another two years.
- Connecticut limited the transfer of film production credits and New Mexico placed a $50 million cap on such credits and staggered payment schedules.

- Alabama double-weighted the sales factor portion of the corporate income tax for a projected revenue gain of $20 million.

Sales and Use Tax (net decrease: $5,245 million)

Twelve states decreased general sales taxes, and seven raised them. The expiration of a temporary rate increase in California accounts for the bulk of the reduction, while much of the increase is attributable to the sales tax base expansion in Connecticut.

The sales tax cuts include:

- The temporary sales tax rate increase in California expired on July 1, 2011, lowering the rate from 8.25 percent to 7.25 percent, resulting in future annual revenue loss of $4.5 billion.
- North Carolina lawmakers also let a 1 percent temporary sales tax rate increase expire for a revenue reduction of nearly $1 billion.
- New York approved a sales tax exemption for clothing items costing less than $55 until March 31, 2012. After that, clothes that cost up to $110 will be exempt. The revenue loss is estimated at $300 million.
- Arkansas reduced sales taxes by more than $26 million for FY 2012. Lawmakers cut the sales tax rate on groceries by 0.5 percent and reduced the sales tax rate that manufacturers pay on natural gas and electricity.
- Arkansas lawmakers also approved their state's first sales tax holiday on clothing and school supplies.
- West Virginia reduced the sales tax rate on food from 3 percent to 2 percent.
- Colorado restored a previous exemption for certain agricultural products and exempted certain down-loaded software.

At the same time, some states raised sales taxes:

- Policymakers in Connecticut raised the general sales tax rate from 6 percent to 6.25 percent and raised the rate on certain luxury items to 7 percent.
- Connecticut also expanded its sales tax base to a number of services including pet grooming, spa services, cosmetic surgery, motor vehicle towing, yoga classes and non-prescription medicine, among others.
- Hawaii expects to generate $170 million by suspending for two years certain exemptions from the general excise tax.
- Nevada extended a temporary sales tax increase for another two years, with the revenues earmarked for school support.
- California lawmakers approved a measure requiring some retailers to collect taxes on remote sales and Texas expanded the definition of "nexus" for sales tax collections.

- Georgia expects to generate an additional $18 million by bringing the state sales tax into full compliance with the streamlined sales tax agreement.
- Rhode Island extended its sales tax to include a number of previously exempt items including nonprescription drugs, travel and tour company products, insurance proceeds for vehicles, and prewritten downloaded software.

Health Care Provider and Industry Taxes (net increase: $1,956 million)

States continue to increase health care provider taxes as a way to cover rising Medicaid costs. Fifteen states raised these taxes for more than $1.8 billion while only one state reduced these taxes, giving this category the second largest increase in 2011.

- Indiana adopted a new 2.7 percent hospital assessment for two years and raised the health facility quality assessment from 4 percent to 5.5 percent for three years. These two measures are projected to bring in more than $450 million in FY 2012.
- Connecticut expects to generate nearly $400 million by imposing a new tax on hospital net revenue and a new resident day user fee for certain intermediate care facilities. Lawmakers also increased the cap on nursing home resident user fees.
- Idaho raised assessments on hospitals and nursing homes for three years.
- Maryland adopted a new hospital assessment for an anticipated $280 million in additional revenue.
- Oklahoma approved a new hospital assessment of 2.5 percent of net patient revenue to raise $152 million to help offset higher Medicaid costs.
- Maine, Nebraska, North Carolina, Ohio, Oregon, Rhode Island, Utah, Vermont, Virginia and West Virginia also raised hospital and health care taxes.

One state cut taxes on health care providers:

- Florida lawmakers approved an insurance premiums tax exemption for health care providers that only serve Medicaid recipients for certain health services.

Tobacco Taxes (net increase: $52 million)

In a departure from past years, states made few changes to tobacco taxes: three states raised taxes on cigarettes or other tobacco products and one state reduced them.

- Connecticut increased the excise tax on cigarettes by $0.40 per pack and nearly doubled the tax on other tobacco products from 27.5 percent to 50 percent.
- Vermont raised the cigarette tax from $2.24 per pack to $2.62 per pack.
- Texas reduced the cigarette tax stamping discount from 3 percent to 2.5 percent.

One state cut tobacco tax rates.

- New Hampshire lawmakers reduced the state's cigarette tax from $1.78 per pack to $1.68 per pack.

Alcohol-Related Taxes (net increase: $24 million)

Three states raised alcohol taxes and one state made a change that reduced the sales tax on alcoholic beverages:

- Oregon imposed a $0.50 per bottle surcharge on spirits for two years to raise $14 million.
- Connecticut raised the alcoholic beverage excise tax by 20 percent to generate $10 million.
- Maryland raised the sales tax on alcoholic beverages from 6 percent to 9 percent to generate $84 million (this action is counted in the sales tax totals).
- Massachusetts voters repealed the state sales tax portion of the alcoholic beverages tax.

Motor Fuel Taxes (net increase: $12 million)

Two states raised taxes on motor fuel:

- Connecticut increased the base diesel tax for a projected $8.5 million.
- Maine indexed the gasoline tax and special fuels tax to inflation for an estimated $4.1 million in revenue.

One state cut motor fuel taxes:

- New York exempted alternative motor fuels from fuel and sales taxes for one year.

Miscellaneous Taxes (net decrease: $929 million)

More states raised miscellaneous taxes than reduced them, but the cut in California's ad valorem car tax was large enough to offset all the other tax increases and resulted in an anticipated net reduction of more than $900 million.

States cut a variety of other taxes:

- California lawmakers let a temporary increase in the value-based car tax expire, reducing tax collections by an estimated $1.3 billion.
- Oklahoma reduced the annual tax on coin-operated vending machine decals.
- Ohio eliminated the state estate tax for deaths after Jan. 1, 2013.
- Indiana reduced the tax on racino slot machine wagering.

Other states raised some miscellaneous taxes:

- Illinois reinstated its estate tax to generate more than $180 million a year.
- Connecticut raised estate and gift taxes by lowering the exemption threshold from $3.5 million to $2 million.

- Connecticut also established a new tax on the generation of electricity for an additional $71 million.
- Nevada will raise additional revenues by changing its tax on net proceeds of minerals.
- Connecticut raised the hotel room occupancy tax, and South Dakota extended its temporary tourism tax increase for another two years.

Fees and Other Nontax Changes (net increase: $1,019 million)

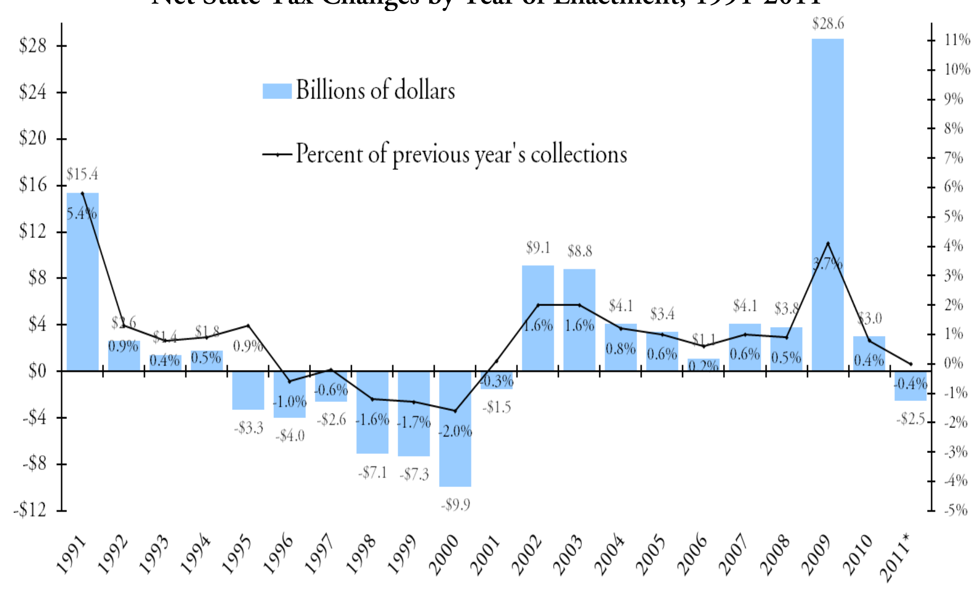
Eighteen states increased various fees in 2011, while three states cut them. One state accelerated revenue collections, and five states turned to non-tax revenue sources such as enhanced compliance and tax enforcement efforts.

For example:

- California raised car registration fees by $12 to generate $300 million.
- Rhode Island raised beach fees to generate an additional $1.5 million.
- Lawmakers in North Carolina raised a number of court and miscellaneous fees.
- Texas accelerated more than $500 million in tax collections into FY 2013 from FY 2014.
- California, Idaho and Oklahoma stepped up efforts to improve tax compliance by adding tax collectors and enhancing audit efforts.
- Tax amnesty programs were approved in several states, including, California, Colorado and Ohio.

Overall, the 50 states made tax, fee and other revenue changes that will result in an anticipated $1.29 billion decrease in revenues for FY 2012.

Net State Tax Changes by Year of Enactment, 1991-2011



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