ISSUE

Income Tax Cuts

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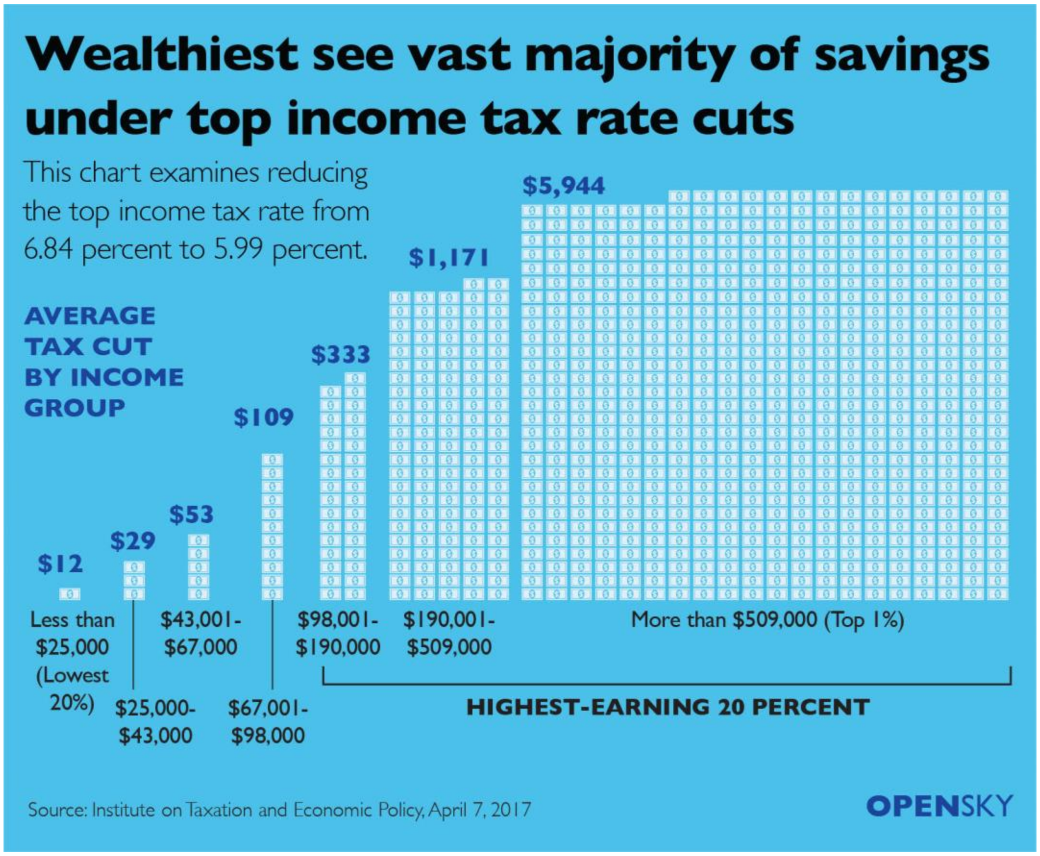
RECOMMENDATION:

Do not reduce state income taxes.

OVERVIEW

Nebraska taxes both personal and corporate income. Personal income tax collections accounted for $2.2 billion in revenue in FY16-17. Corporate income tax collections accounted for $264 million in revenue in FY16-17.[1] The income tax is a progressive tax, which means people pay higher rates as their incomes increase. That's why higher earners benefit the most when income taxes are cut. This is particularly true when the top income tax rate is cut, as has been proposed several times in recent years. (See graphic below.)



INCOME TAX CUTS COSTLY TO THE STATE

There have been several income tax cuts since 2006, which collectively reduced state revenue by approximately $267.9 million in FY17 alone,

Personal income tax rates

Nebraska's personal income tax rates, which apply to taxable income, are:

2.46% on individual income up to $3,090, married filing jointly income up to $6,170.

3.51% on individual income between $3,090-$18,510, married filing jointly income between $6,170- $37,030;

5.01% on individual income between $18,510-$29,830, married filing jointly income between $37,030-$59,660

6.84% on individual income above $29,830, married filing jointly income above $59,660.[2]

according to the Legislative Fiscal Office.[3] In 2006 and 2007, LB 968 and LB 367 (respectively) adjusted the brackets, added and expanded the earned income tax credit and eliminated the marriage penalty among other changes. These changes reduced revenue by $142.3 million in FY17. LB 970 in 2012 further changed brackets and rates, reducing revenue by another $61.3 million in FY17. LB 987 in 2014 indexed Nebraska's income tax brackets for inflation and broadened the Social Security exemption. This reduced revenue by $38.1 million in FY17. Institute on Taxation and Economic Policy (ITEP) data shows that if Nebraska's top rate had been 5.99 percent in 2017, it would have reduced state revenue by about $212 million.[4]

NO CONSENSUS REGARDING LINK BETWEEN TAX CUTS AND ECONOMIC GROWTH

Academic research fails to find consensus regarding the effect of income tax cuts on economic growth.[5] For its part, Nebraska outperforms most states with lower or no income taxes economically and had the fifth-fastest growing economy between 2006 and 2016.[6] A Nebraska Department of Revenue study released in 2017 showed that a $100 million sales tax cut would generate more economic activity than a $100 million income tax cut but that neither would come close to paying for themselves with increased economic activity.[7] Cutting income taxes also is unlikely to help the state attract new businesses as site selector data shows companies are more concerned with infrastructure and other factors than with state taxes.[8] The revenue losses created by further cutting the income tax would, however, hinder investments in infrastructure, schools, public safety and other services businesses and Nebraskans care about. In their research on the effect of tax cuts and budget cuts on economies, Wichita State University professors Arwiphawee Srithongrung and Ken Kriz found that, over time, the negative economic effects of funding cuts normally significantly outweigh any positive economic impact of tax cuts.[9]

KANSAS AND OKLAHOMA EXPERIENCES HIGHLIGHT RISKS OF INCOME TAX CUTS

In states like Kansas and Oklahoma, income tax cuts have been linked to major budget problems and have not brought the promised economic growth. In fact, Kansas' economy underperformed the U.S. economy following its tax cuts[10] with Kansas employment growing 2.6 percent and national employment growing 6.5 percent.[11]

Corporate income taxes in Nebraska

Under Nebraska's corporate income tax rates, taxable profits up to $100,000 are taxed at 5.58 percent, and taxable profits above $100,000 are taxed at 7.81 percent.[12] Less than one-fifth of Nebraska businesses pay through the corporate income tax, as the vast majority of businesses file under the personal income tax.[13] This means most businesses in Nebraska would not benefit from a corporate income tax cut.

Furthermore, Kansas' gross domestic product (GDP) grew 4.8 percent while national GDP increased 11.9 percent. In 2017, Kansas rolled back some of its income tax cuts after years of damage to education, roads and other vital services,[14] and Oklahoma lawmakers repealed a triggered income tax cut amid that state's persistent budget issues.[15]

UNKNOWNS AND PENDING FUTURE CHALLENGES MAKE IT A BAD TIME FOR INCOME TAX CUTS

Enacting further revenue reductions by way of income tax cuts is particularly risky at this time for several other reasons. Demographic changes such as an aging population and a population shift that has many rural Nebraskans moving to urban parts of the state both have significant fiscal implications for Nebraska. Such changes – particularly as it pertains to the increasing health costs of our aging population – are among the reasons a recent U.S. Government Accountability Office report shows states could face a 40-plus year run of revenue shortages.[16] Also, there is not yet a firm understanding of how recently-passed federal tax cuts and the federal funding cuts that are likely to accompany them will impact state revenues and funding for key services. Even without further reductions at the state level, Nebraska could lack the revenue needed to fund health programs, schools and other vital services in the future. Revenue reductions caused by income tax cuts would likely compound these struggles considerably.

REVENUE TRIGGERS ARE IRRESPONSIBLE TAX POLICY

Revenue triggers are used to enact future tax cuts when state revenues or revenue projections reach certain thresholds. The thresholds are often arbitrary and have led to scenarios where income taxes were cut at particularly bad times. For example, a trigger in Oklahoma caused an income tax cut in 2016 just as oil prices plummeted. This contributed to a budget crisis in which nearly one third of Oklahoma's school districts moved to four-day school weeks.[17] A triggered income tax cut was proposed in Nebraska in 2017 and, had it been in place since 2001, several tax cuts would have been enacted, including one during the recession of the early 2000s, one during "The Great Recession" and another in 2016 just as a downturn in the agricultural economy and other factors contributed to a large revenue shortfall. In 2018, a triggered property tax rebate was proposed. Had this trigger been in place since 2001, nine years of tax cuts would have been enacted with four consecutive years of cuts between FY04-05 and FY07-08 and five consecutive years of cuts between FY10-11 and FY14-15.

Tax cut triggers would set tax cuts on autopilot, would not allow lawmakers to respond to state needs in economic slowdowns or natural disasters and

Most Nebraskans' actual tax rates less than 6.84%

Department of Revenue data shows the effective state income tax rate – the percentage of income actually paid in state income tax after credits and deductions – was 4.08 percent in 2015 for the top 500 wealthiest taxpayers in Nebraska.[18] This is nearly three percentage points lower than the state's 6.84 percent top income tax rate. The data shows that 70 percent of Nebraskans paid an effective income tax rate of 1.73 percent and the highest average effective income tax rate was 4.91 percent, which was paid by the wealthiest 10 percent of Nebraskans.

they would make it difficult for the state to replenish its cash reserve during upswings in the economy because revenue growth would spark more tax cuts. These qualities of revenue triggers could lead to deep cuts for schools, health care, roads, law enforcement and other vital services that Nebraskans need.

INCOME TAX CUTS NO BOON FOR SMALL BUSINESSES

The vast majority of small businesses pay personal income tax. As of 2014, 86 percent of small businesses made less than $50,000 in total income and the average small business subject to the individual income tax has $27,484 in taxable income.[19] This business would receive no tax cut should the top income tax rate be reduced.

CONCLUSION

Income tax cuts have little-to-no economic impact and, in fact, likely would hurt the state in the long run by draining resources from schools, health care and other building blocks of a strong economy. Based on the experiences of states like Kansas and Oklahoma and the possibility of a decades-long run of revenue shortages, it makes little fiscal sense to implement risky measures like income tax cuts at this time.

Taxes have little impact on migration

Income tax cuts are unlikely to affect migration into and out of Nebraska. Academic literature finds no conclusive evidence that people move because of tax rates. According to 2012-2013 U.S. Census Bureau data, Americans reported that housing, family and employment were more important factors in relocation decisions than taxes.[20]

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