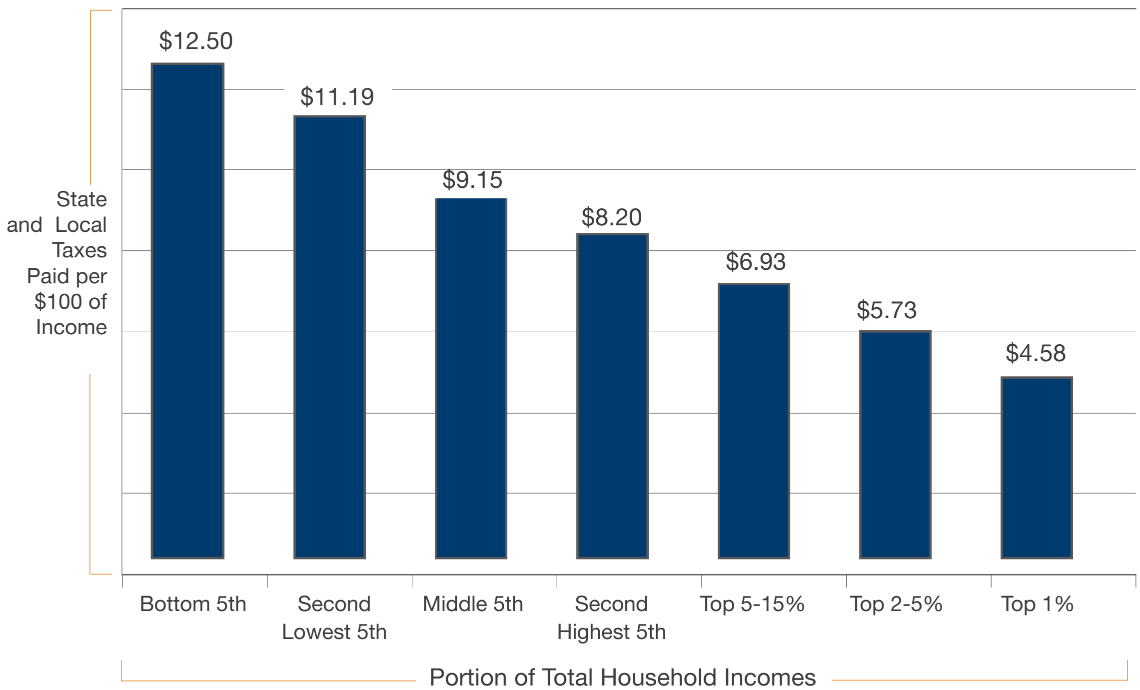
TAX CUTS AND TAX CREDITS

Do low-income families pay their share of taxes?

Yes. All families in Arizona help pay for health, education, and public safety through state and local taxes. Low-income families pay a larger portion of their income in taxes than do wealthier families.

When all types of state and local taxes are combined—income, sales and property—families with incomes in the bottom fifth pay nearly three times what families in the top 1 percent do—$12.50 for every $100 of income compared to $4.58 for the highest income families. Sales taxes make up the largest portion of the taxes paid by those with the lowest incomes. Families with the lowest incomes in Arizona also pay more of their income in state and local taxes than do the lowest income families in neighboring states.

Arizona Families with Lowest Incomes Pay a Higher Portion of Their Income in State and Local Taxes than Taxpayers with Higher Income



Source: Institute on Taxation & Economic Policy, *Who Pays?*, January 2015.

TAX CUTS AND TAX CREDITS

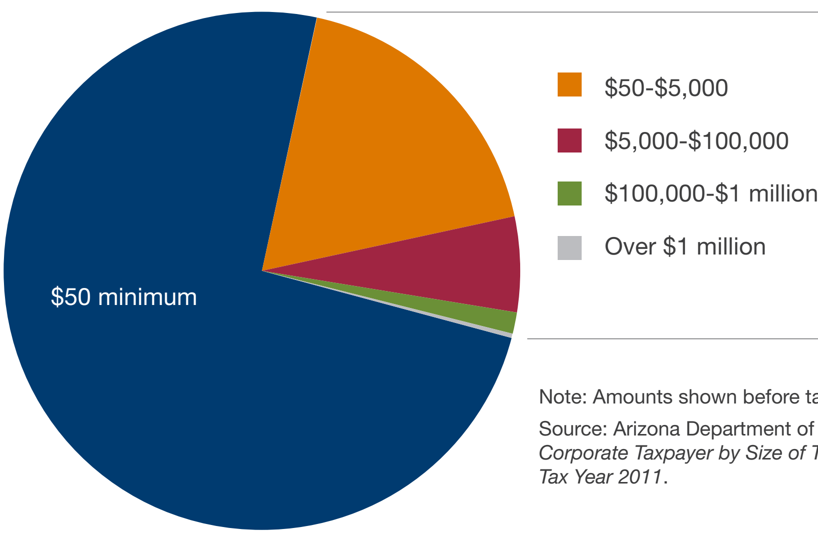
Who doesn't pay state income taxes?

Surprisingly, corporations and individuals at all income levels can end up paying little or no state income taxes.

Three out of four corporations that filed income taxes in Arizona in 2011 had the minimum tax liability of $50. Fewer than one in ten corporations paid $5,000 or more in income taxes.

Like individual taxpayers, corporations can significantly reduce or eliminate entirely their income tax bill through the use of tax credits. In 2011, corporations reduced their tax liability by $119.6 million through the use of tax credits and carried another $1 billion over to be used in future years.

Only One-Fourth of Arizona Corporations Owed More than the $50 Minimum Corporate Income Tax in 2011



Note: Amounts shown before tax credits.

Source: Arizona Department of Revenue, *Corporate Taxpayer by Size of Tax Liability, Tax Year 2011*.

Households might pay no state income taxes for one of two reasons:

- Their incomes fall below $11,000—the threshold set in state law for filing a state income tax return, or
- They have higher incomes, but their tax liability is erased through the use of exemptions, deductions, and tax credits.

For example, a family with income that falls within the second highest tax bracket (between $100,001 and $300,000) can end up owing no income taxes through common deductions and credits.

Arizona Income Tax Return for Family of Four

Federal adjusted gross income	$134,000
Subtractions	
Standard deduction	-10,010
Personal exemptions	-6,300
Dependents (2)	-4,600
Taxable Income	113,090
Tax (Income x .0424 less $1,178)	3,617
Credits	
Student Tuition Organization	-1,056
Student Tuition Organization - “switcher”	-1,050
Qualifying charitable organization	-800
Public schools extracurricular activities	-400
Military Family Relief fund*	-311
Subtotal - Credits	-3,617
Taxes Owed	**0**

*A maximum of $400 could be claimed; however, only $311 was needed to eliminate tax liability.

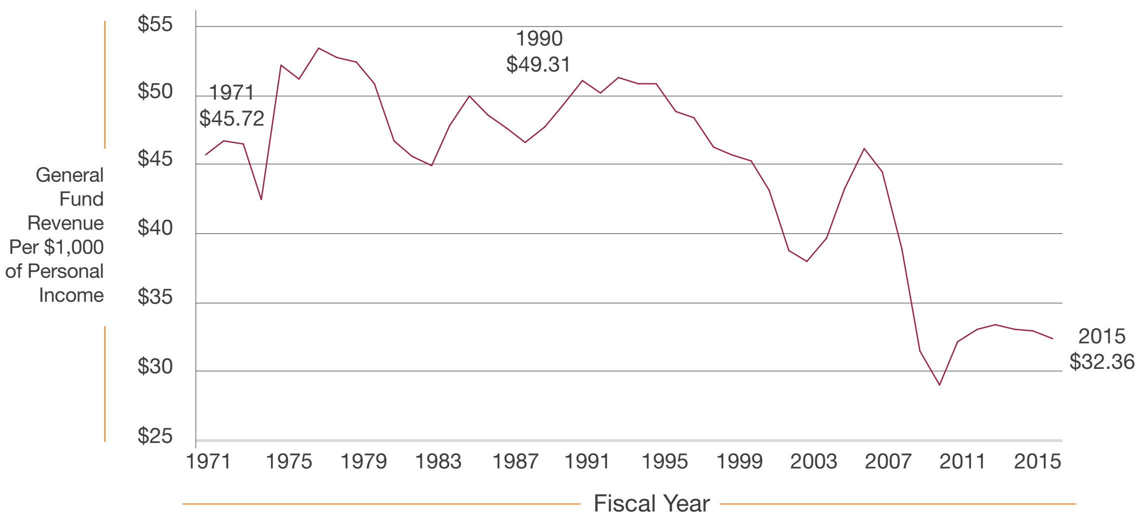
TAX CUTS AND TAX CREDITS

Has Arizona been cutting taxes?

Yes. With the exception of 2003, the Arizona legislature has reduced tax rates and/or increased exemptions and credits in every year since 1990. By fiscal year 2017, the cumulative impact of this steady stream of tax cuts enacted since 1990 will reach $1.8 billion less in general fund revenues—more than double that when you adjust for inflation.

Even during the Great Recession when drastic spending cuts were made to keep the budget balanced, hundreds of millions of dollars in tax cuts were passed. In 2015, state general fund revenues were $32.36 per $1,000 of income—one-third lower than in 1990 and 17 percent lower than right before the Great Recession.

State General Fund Revenue as a Share of Personal Income Has Dropped Significantly Since the Early 1990s



Source: Tabulations prepared by Tom Rex, Associate Director, Center for Competitiveness and Prosperity Research, Arizona State University, based on data from Joint Legislative Budget Committee Staff, *Appropriations Report,* and the U.S. Bureau of Economic Analysis.

All types of taxes have been cut since 1990. Examples include:

- Both the corporate and individual income tax rates have been cut 5 times at a total annual cost to the general fund of $1.2 billion, not adjusted for inflation. Today, the individual income tax rate for the highest income bracket is less than two-thirds of what it was in 1990, while the corporate income tax rate is currently in a four-year phase down. In tax year 2017, the corporate income tax will be just over half (52 percent) of what it was in 1992.
- 33 individual income tax credits have been adopted, with 27 of them still being in place. The total annual cost of these credits, excluding any carry forward amounts, is approximately $202 million.
- 26 corporate income tax credits have been adopted, with 21 of them still being in effect. The annual cost of these credits, excluding any carry forward amounts, is approximately $129 million.
- New exemptions and increased deductions for both corporate and individual income taxes amount to $210.8 million annually, not adjusted for inflation.
- Allowing multistate corporations to choose their preferred method for determining their taxable income, called single sales factor, means $122 million less per year in state revenues.

Many of the tax cuts passed since the Great Recession began are phasing in over a number of years, starting out relatively small but growing into the future. In particular, the so-called "Jobs" bill passed in 2011 was estimated to cost the general fund $38.2 million in fiscal year 2012 but has an estimated $538 million impact by the time it is completely phased in fiscal year 2018. The phased provisions include reducing the corporate income tax rate, reducing the commercial property tax assessment, and reducing the corporate sales factor, which affects multistate corporations.

The most recent legislature continued this practice of passing tax cuts that have little impact now but will grow over time. A reduction in the insurance premium tax rate is estimated to cost the general fund $1.3 million in fiscal year 2017, but will grow to $35.2 million annually over 10 years.

The assumption behind this phasing in of tax cuts is that the economy will improve over time so that the revenues lost due to the tax cuts will be made up by growth in the overall economy. Unfortunately, this has not worked out—over one-third of the $1 billion deficit for fiscal year 2016 is attributable to tax cuts passed since 2009.

CHILDREN'S ACTION ALLIANCE

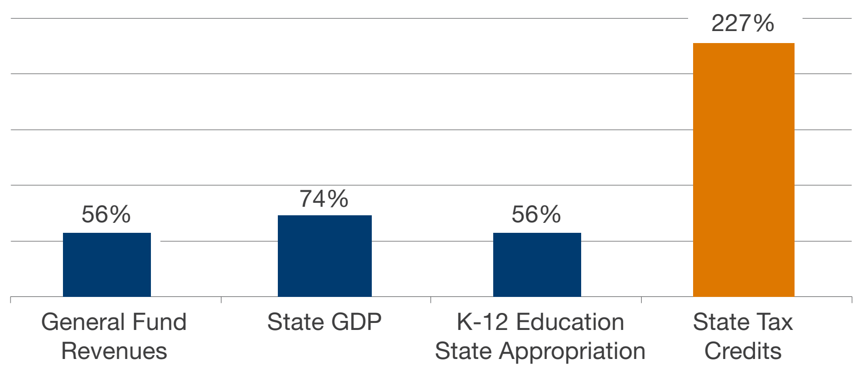
TAX CUTS AND TAX CREDITS

What are tax credits doing to the state budget?

Tax credits cost the state budget $311 million in 2012 and have been growing fast. They compete with state agency budgets for the same pot of funding, but state lawmakers have virtually no accountability or control over tax credits once they are in state law.

A tax credit reduces the amount of taxes owed on a dollar-for-dollar basis—a $400 tax credit can wipe out a $400 tax bill. The dollar value of tax credits claimed is growing at a much faster rate than state revenues, the state's economy, or state spending on K-12 education. Each legislative session since 2005, at least one new tax credit has been added or expanded. Between 2010 and 2013, even as state revenues were plummeting due to the recession, eight new credits were created. Today there are 27 credits available to individuals and 22 available to corporations.

Tax Credits Are Growing Fast - Percent of Growth 1999 to 2012



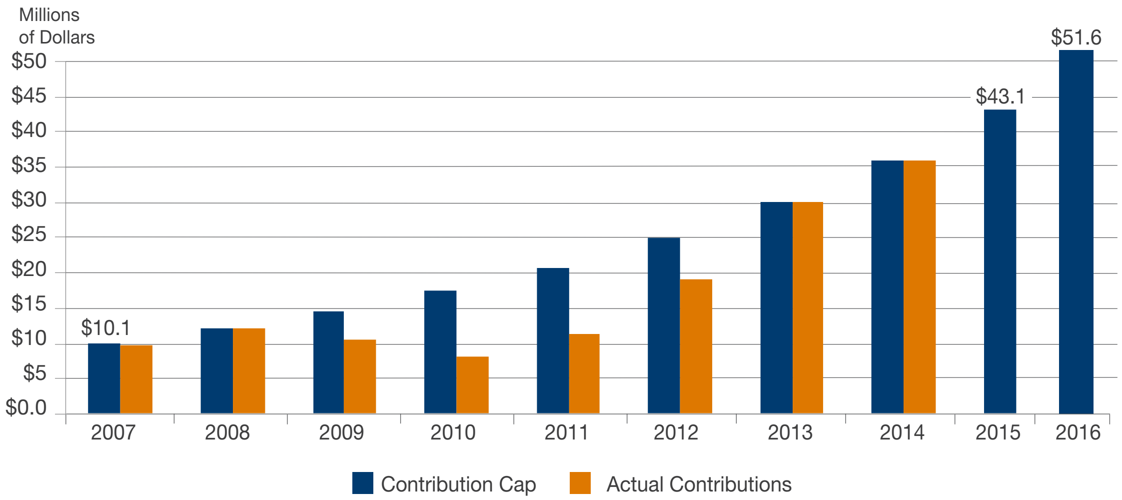
Source: Joint Legislative Budget Committee Staff, *Appropriations Reports for FY 1999, FY 2000, FY 2012 and FY 2013*; Arizona Department of Revenue, *Arizona Income Tax Credits*, November 2014; U.S. Bureau of Economic Analysis, *Gross Domestic Product by State*.

Tax credits lack the basic accountability and control that state spending has. Unlike agency budgets that must be approved by the state legislature every year, tax credits are reviewed only once every five years. Even after a review that shows questionable results, tax credits continue forever unless a bill to repeal them passes with a two-thirds vote in both the house and the senate. While state agency spending is capped at the appropriated amount, only 10 out of the 49 credits have an aggregate cap. State legislators don't know what the fiscal impact of any tax credit will be in any particular year until after the credit has already been taken.

The expansion of the private school tuition tax credits in particular is having a significant impact on state revenues. Arizona now has two individual and two corporate tax credits for contributions to “student tuition organizations” that use the funding to grant scholarships for private school tuition. Combined, the amount claimed for these four credits rose from under $14 million in 1999 to $108 million in 2013. The largest of the corporate tax credits (shown below) has an aggregate cap that grows by 20 percent each year and has been maxed out the last several years.

Corporate Private School Tuition Tax Credit Cap Doubles Every Four Years

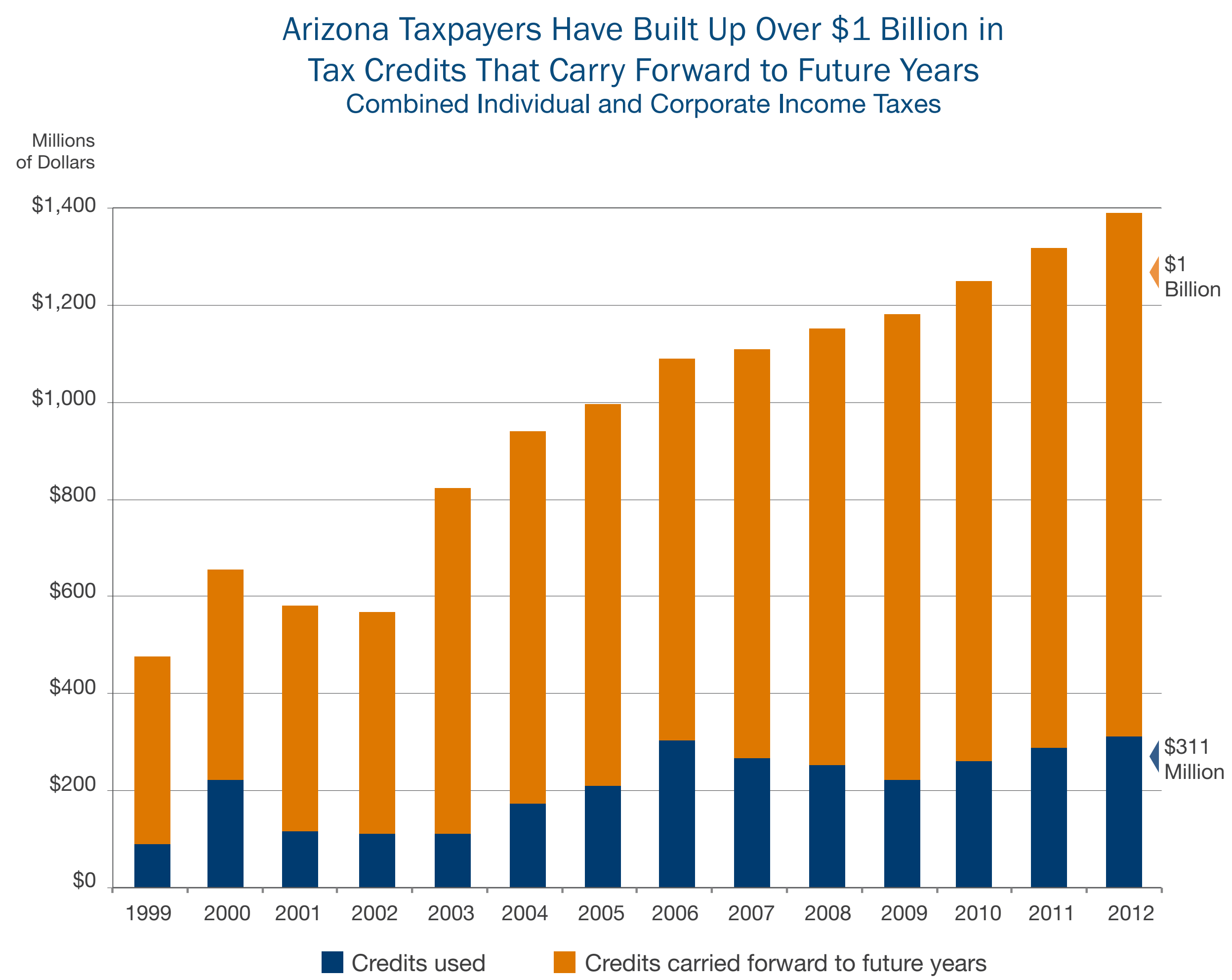
Corporations Now Maxing Out Their Contributions Every Year



Source: Arizona Department of Revenue, Arizona Income Tax Credits, November 2013; calculations by Children’s Action Alliance.

Another feature that puts tax credits outside legislative budget control is the carry forward balance that taxpayers are allowed to accumulate and use in future years. For most tax credits, if taxpayers don’t owe enough income taxes to use the whole credit, they are allowed to save the unused portion of the credit and apply it against future tax liability. For instance, if a taxpayer owes $300 in taxes and has contributed $400 to the qualifying charitable organizations tax credit, the $100 unused portion of the credit can be carried forward and used on the next year’s tax return. The number of years a credit can be carried forward ranges from 5 to 15 years.

Today, individuals and corporations are carrying forward a combined $1 billion balance in tax credits that can hit the state budget at any time. This carry-forward amount is three times greater than the credits claimed in any single year. The carry forward balance for corporations is expected to grow because the amount of corporate taxes due will decrease with the phasing down of the corporate tax rate.



Source: Arizona Department of Revenue, *Tax Credit Report*, November 2014.

TAX CUTS AND TAX CREDITS

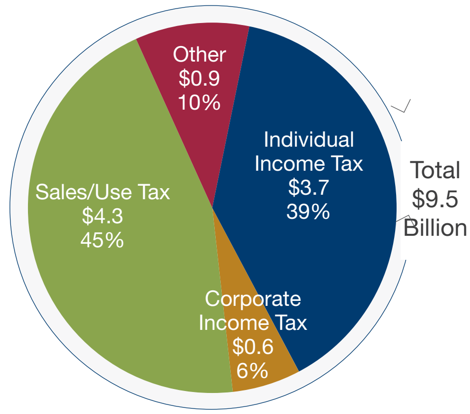
What would happen if Arizona eliminated the income tax?

State income taxes for individuals and corporations make up nearly half of all revenue to the state general fund. Eliminating these taxes would have a dramatic impact on Arizona families—including a potentially huge loss of state services or huge shifts in taxes from wealthier Arizonans to middle and lower income families.

If Arizona were to eliminate the income tax and increase the sales tax to make up for the revenue loss, Arizona's sales tax rate would grow from the current 5.6 percent to about 10.6 percent. Arizona's rate would become the highest in the nation, significantly higher than the current top spot of California at 7.5 percent.

Sources for General Fund, FY 2016

(Dollars in Billions)



Source: Joint Legislative Budget Committee Staff, *Appropriations Report FY 2016.*

Replacing income taxes with sales taxes would also shift tax responsibility away from higher income Arizonans to those earning middle and low incomes. Under this approach, 80 percent of Arizonans would see their state taxes go up, while the wealthiest 20 percent would see a tax cut.

Alternatively, trying to cut spending to make up for the lost income tax revenue would drastically disrupt basic state priorities. Would the legislature simply cut all state agency budgets in half, regardless of the impact? Would the general fund cover just K-12 education and Child Safety with zero funding for prisons, universities, health care, and the Department of Public Safety? Would the group homes and services for people with developmental disabilities be closed? Would the 1.6 million Arizonans who depend on AHCCCS for health care suddenly be without any coverage, disrupting the health care system statewide?

TAX CUTS AND TAX CREDITS

CHILDREN'S ACTION ALLIANCE

Should Arizona cut more taxes now to spur job growth?

No. The link between tax cuts and economic growth is unproven and inconsistent. Arizona's economy has had both ups and downs during our 25 years of tax cuts. Given our current fiscal conditions, more tax cuts will mean more spending cuts that weaken our economic infrastructure and dampen job growth.

Arizona has been cutting taxes consistently for 25 years. We kept cutting taxes right through the Great Recession and beyond and some of those tax cuts are still phasing in. Despite the continuous tax cuts and the accompanying promises that they would supercharge our state economy, recovery from the recession remains painfully slow.

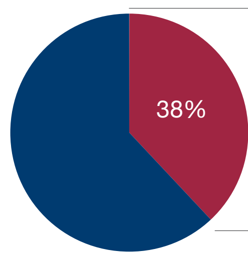
The fact is that the link between tax cuts and economic growth is a messy business. There is no clear consensus and no consistent research results to prove the argument that tax cuts grow jobs.

One thing is clear. Cutting taxes means cutting revenues. Even Alan Viard from the famously conservative American Enterprise Institute says that's obvious. In an October 7, 2012, C-Span interview he said: "It is correct of course that tax cuts are not revenue increasing. The incentive effects are not big enough so that you actually will raise more revenue."

And what happens when we reduce revenues? We have to cut spending.

The tax cuts passed by the state legislature just since the recession in 2009 account for more than one-third of the projected budget shortfall in fiscal year 2016. If we hadn't wiped out that $383 million in revenues, we could have avoided ***all*** of the new budget cuts this year to K-12 and higher education, the cuts to child safety and economic security, and the cuts to our health care system.

Tax Cuts Passed Since the Recession Account for More Than One-Third of the FY 2016 $1 Billion Revenue Deficit



38%
of projected budget deficits are due to tax cuts passed since 2009

Source: Joint Legislative Budget Committee Staff, Finance Advisory Committee Presentation, January 22, 2015; *2014 Tax Handbook.*

The spending cuts following a tax cut can cause economic damage themselves, running directly counter to the intent. As described by the WP Carey School of Business at Arizona State University: "Empirical evidence exists that public infrastructure plays a role in increasing business investment, job creation and economic growth. Similarly, tax reductions financed by cutting education, infrastructure spending, and other services valued by businesses will have a negative effect on economic performance" (*A Summary of the Arizona State Government Fiscal Situation*, March 2009).

In recent years, some Arizona leaders have pronounced that Arizona should be less like California and more like Kansas when it comes to taxes. But the real life results don't back up the pronouncements.

In the fall of 2012 California voted to increase the state sales tax as well as income taxes for the wealthiest Californians. One executive there predicted that this temporary rate increase would cause his state's economy to self-destruct and that more companies "would be motivated to find greener pastures." The Greater Phoenix Economic Council announced it would offer free airfare and hotel rooms to the first 100 California CEOs and high-tech, high-wage business owners who wanted to look at moving to Arizona.

So, did the predictions of California's demise come true? Not at all. According to the U.S. Bureau of Labor Statistics, Arizona has added 130,300 new jobs since December 2012—a 5.2 percent increase. But California grew far more jobs than Arizona—adding over 1 million jobs with a 7.1 percent increase.

	Jobs Gained (December 2012 to March 2015)	Percent Increase
Arizona	130,300	5.2%
California	1,054,700	7.1%
Kansas	42,300	3.1%
U.S.	6,090,000	4.5%

While California raised taxes, Kansas went in the opposite direction. Governor Brownback and the Kansas state legislature cut personal income tax rates significantly and made some other tax changes to replace some of that revenue in 2012 and 2013. They said the tax cuts would grow the economy, bringing prosperity to Kansans. But these two rounds of tax changes have left a large and growing hole in the state's budget—shrinking school funding and other public services. At the same time, Kansas job growth of 3.1 percent since December 2012 has lagged ***behind*** the national average of 4.5 percent.

It's clear that there is no automatic, guaranteed link between tax cuts and job growth. It all depends on where you start and what you do with both sides of the ledger. Whether it's a business or an individual, economic decisions about relocation and investment depend on many factors—and taxes are far from the top of the list.