



With Pro-Growth Elements, HB 2015 is a Good Tradeoff

House Bill 2015 has drawn considerable interest and caused controversy among Republicans, fiscal conservatives, and other interests. While the Arizona Free Enterprise Club does not support raising taxes to balance the budget, the AZFEC supports HB 2015 because the size and permanency of the tax cuts outweigh the possibility of the tax increase.

Property Taxes

The permanent repeal of the state equalization rate is a significant tax reform given the current tatters of the Arizona economy. This provision effectively stops a major tax increase in its tracks. While the governor signaled a willingness to allow this tax to increase (both in negotiations and through her veto stamp), the legislature has worked with clarity not only this year, but in the previous two, to ensure homeowners and businesses remain free of this property tax.

Critics of the repeal argue that this tax predominately benefits businesses. Leaving aside the fact that businesses are run by people, more than half – 57 percent – of the \$250 million tax would be borne by residential (owner-occupied and rental) property owners, while 41 percent would be shouldered by commercial, industrial, utilities, mines and agricultural interests. Furthermore, if critics believe that businesses disproportionately benefit by not having the tax, then businesses must disproportionately suffer if the tax were to return. Since we're all relying on business activity to pick up, it makes little sense to raise this tax.

The passage of HB 2015 would drive a stake through this tax.

Permanent income tax cuts

HB 2015 includes permanent tax rate reductions with an estimated tax savings of \$400 million a year. These marginal rate cuts take effect January 1, 2011. The corporate income tax rate would drop 30 percent, from 6.968% to 4.86%. The individual income tax rates would decline by 6.6 percent.

Corporate Income Taxes

Arizona's current corporate income tax rate is the third-highest among ten western states (only California and New Mexico's are higher). This tax change would drop Arizona to the fourth-lowest among those states including three states that don't tax corporate income (Nevada, Washington, and Wyoming).

High taxes increase the cost of capital. There are countless papers that demonstrate the negative consequences high corporate taxes have on job growth, investment, and wages. According to a new study by the Tax Foundation, "The Corporate Income Tax and Workers' Wages: New Evidence from the 50 States," Senior Fellow Robert Carroll,

Ph.D., finds that states with high corporate income taxes have likely depressed their workers' wages over the long term, while states with low corporate taxes have boosted worker productivity and real wages.

According to the National Center for Policy Analysis:

- The Congressional Budget Office estimates that workers bear slightly more than 70 percent of the burden of high corporate taxes in the form of reduced wages.
- A \$1 increase in corporate taxes tends to reduce real median wages by 92 cents, concludes an Oxford University study.
- A 1 percentage-point increase in corporate tax rates is associated with nearly a 1 percent drop in wage rates, according to an American Enterprise Institute (AEI) study.

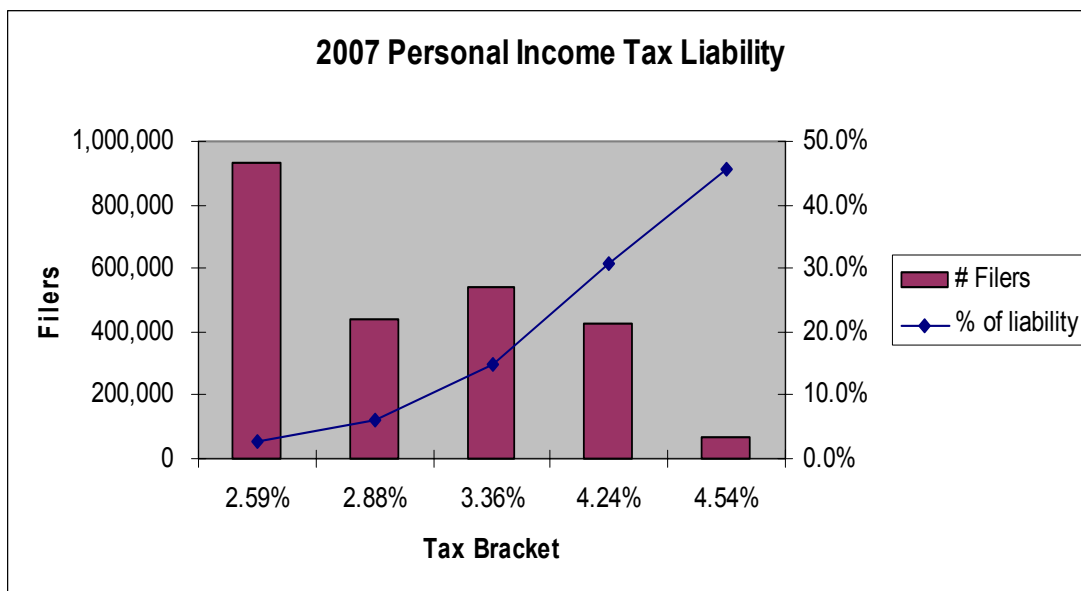
According to a 2005 AZDOR breakdown of corporate income taxes, less than one percent of Arizona corporate income taxpayers paid 61 percent of corporate income taxes. Reducing the rate by 30 percent would reduce the incentive for companies to report less income, allocate income to states with lower tax rates, and otherwise structure activities to minimize their tax burdens.

The HB 2015 corporate income tax cut would do more for long-term economic development and job creation than any of the tax credits and industrial policies passed in recent years because it would immediately signal to corporations both in and out of Arizona that a more business friendly and competitive tax structure is imminent.

Individual Income Taxes

HB 2015 includes a 6.6 percent across-the-board reduction in Arizona personal income taxes. As a policy matter, this tax cut would lessen the government burden placed on both entrepreneurs and employees of entrepreneurs. In this economy, especially, that's a good thing. According to NFIB, more than 70 percent of Arizona small businesses pay taxes in the individual income tax system.

Currently, only 20 percent of taxpayers pay 76 percent of Arizona income taxes (see chart).



Perhaps as important as the new rates is the fact that the this tax policy change would signal to the rest of the country that Arizona is entering a period of pro-growth tax cuts.

In Conjunction with the Sales Tax Increase Referral

HB 2015 is a single vote that (among other changes) permanently cuts income taxes, prevents a major property tax increase, and refers to the ballot a sales tax increase. The changes are immediate as the property tax increase is dead upon the governor's signature. The income tax cuts begin in January 2011. The sales tax increase is left up to the voters. The AZFEC generally opposes ballot referrals as we believe policy changes of this sort are the purview of the legislature. At times, however, exceptions to rules can be appropriate. Governor Brewer has made it clear through her words and actions that she will not support a budget package that does not include a referral of a sales tax increase. The legislature has tried – again, both through words and actions – to produce a balanced budget without referring the tax increase. The one attempt that reached the governor's desk was vetoed.

Conclusion

In prior budget years, the AZFEC has complained about the willingness of lawmakers to acquiesce to Gov. Napolitano. Aside from tax cuts in 2006 (when the state had a billion dollar surplus), fiscal conservatives got little in return for Napolitano priorities. We believe the policy changes, not only in HB 2015, but in other budget bills, demonstrate an ability to achieve sound, pro-growth policies and an effort to re-assert the legislature's role in the budget process and policy making.

HB 2015 achieves lasting pro-growth tax cuts and prevents property taxes from increasing this year. According to JLBC, the marginal rate cuts will exceed the value of the sales tax increase (should the voters pass it) by fiscal year 2015. For lawmakers who have signed the Americans for Tax Reform Taxpayer Protection Pledge, the president of ATR recently concluded that because the permanent tax cuts exceed the possible tax increase by \$600 million, a vote for HB 2015 does not violate the pledge.

For these reasons, we encourage lawmakers to support HB 2015.