Tax Reform for Oklahoma White Paper

August 9th, 2022

Mike Mazzei, CFP, MPAS,

Master Planner Advanced Studies and

President, Tulsa Wealth Advisors,

Oklahoma State Senator 2004 – 2016,

Chairman of Senate Finance Committee 2006 - 2016

Oklahoma Secretary of Budget 2018 – 2020

Introduction

This paper will document that Oklahoma is not yet a top ten state for job and population growth. To become more pro-growth and join the states with significant population growth, Oklahoma policy makers must change the tax structure to be more competitive in the 21st century economy. To better understand the reforms needed to improve Oklahoma's tax structure, it is critical and useful to recognize Oklahoma's current tax climate; understand the best financial principles for sound tax policy; and finally, to understand the revenue structure of the states with no income tax. We will begin with a look at Oklahoma's current tax policy climate.

Current Tax Climate

If Oklahoma wants to join the top tier of states that are experiencing the most growth, policy makers must endeavor to change significant aspects of Oklahoma's current tax structure.
Well known Reagan economist Art Laffer says it best: That a "pro-growth strategy requires low rates and a broad base of taxpayers" (interview with Larry Kudlow on Kudlow, Fox Business News, May 2022). The Wall Street Journal has consistently documented that no-income tax states have been experiencing both the most economic and the most population growth (WSJ, June 3, 2022). In fact, four of the top ten growth states have no personal income tax: Florida, Texas, Tennessee, and Nevada.

According to the 2022 ALEC – LAFFER State Competitiveness Report, both Texas, our neighbor to the south, and Tennessee, a state similar in population, ranked in the Top Ten of Gross Domestic Product growth over the last decade while Oklahoma ranked #43.

,

According to the Tax Foundation 2022 State Business Tax Climate report, Oklahoma ranks #26 while nine of the ten biggest winners in growth reported by the Wall Street Journal have higher Business Tax Climate rankings than Oklahoma: Florida, Texas, Arizona, North Carolina, Tennessee, Nevada, Colorado, Idaho, and Utah.

Principles for Tax Policy

1. Tax policy should focus on job growth and income growth for all hardworking Oklahomans. Former U.S. Senator Tom Coburn often said that tax policy misses the mark when it “rewards only a few at the expense of middle-class taxpayers.”
2. Policymakers looking to enhance economic prosperity in their states face two diametrically opposed strategies with respect to their tax codes. As one option, they can embrace low, broad-based taxes with zero or minimal carve-outs and special preferences. This approach, referred to by this paper as “growth through markets”, provides all businesses, large and small, with an equal opportunity to grow.
   On the other hand, policymakers can embrace cronyism by providing certain businesses and industries with special targeted tax breaks and tax carve-outs. The “growth through central planning” approach gives some businesses an unfair advantage over others (ALEC “The State Factor” July 2014), something Oklahoma can especially attest to.
3. The cost of tax incentives must have predictability. Many states end up essentially unaware of how many tax credits and target preferences they actually owe to firms and individuals. This introduces massive revenue volatility to tax collections and makes appropriate budgeting, particularly in the context of state balanced-budget requirements, extremely difficult (ALEC “The State Factor July 2014).

,

4. In order to provide guidance for a neutral and effective tax system that will raise needed revenue for core functions of government while minimizing the burden on citizens, a state tax code should adhere to the five guiding principles presented below:

Simplicity – The tax code should be easy for the average citizen to understand, and it should minimize the cost of complying with the tax laws. Tax complexity adds cost to the taxpayer but does not increase public revenue. For governments, the tax systems should be easy to administer, and should help promote efficient, low-cost administration.

Transparency – Tax systems should be accountable to citizens. Taxes and tax policy should be visible and not hidden from taxpayers. Changes in tax policy should be highly publicized and open to public debate.

Economic Neutrality – The purpose of the tax system is to raise needed revenue for core functions of government, not control the lives of citizens or micromanage the economy. The tax system should exert minimal impact on the spending and decisions of individuals and businesses. In accordance, an effective tax system should be broad-based, utilize a low overall tax rate with few loopholes, and avoid multiple layers of taxation through tax pyramiding.

Fairness – The government should not use the tax system to pick winners and losers in society, or unfairly shift the tax burden onto one class of citizens. The tax system should not be used to punish success or to "soak the rich," engage in discriminatory or multiple taxation, nor should it be used to bestow special favors on any group of taxpayers.

,

Competitiveness – A low tax burden can be a tool for a state's private sector economic development by retaining and attracting productive business activity. A high-quality revenue system will be responsive to competition from other states. Effective competitiveness is best achieved through economically neutral tax policies (ALEC "The State Factor" July 2014).

Revenue Structure

Next, we will turn to comparative analysis of states with no income tax. Refer to tables 1-7. Please note that all tax rates, except property tax rates are those in place on January 1, 2021. Property tax rates are calculated as of calendar year 2019. Any dollar values of taxes collected, mentioned within this report, come from fiscal year 2019.

,

States Without Personal Income Taxes: An Overview

Table 1

States of Interest as of January 1, 2022

States Without Personal Income Taxes	Similar Special Cases
Alaska	New Hampshire
Florida	Washington
Nevada	
South Dakota	
Texas	
Tennessee	
Wyoming	

Note. New Hampshire has a single tax bracket for personal income with a rate of 5%, but this 5% "applies to interest and dividend income only" (Tax Foundation, 2022, p. 21). Similarly, Washington has a single tax bracket for personal income with a rate of 7%, but this "applies to capital gains only" (Tax Foundation, 2022, p. 21). Every other state above has no personal income taxes whatsoever. Adapted from *Facts & Figures 2022: How Does Your State Compare? 2022* by Tax Foundation (2022), Table 11 (https://taxfoundation.org/wp-content/uploads/2022/03/Facts-Figures-2022-How-Does-Your-State-Compare.pdf). Copyright 2022 by Tax Foundation.

,

Table 2

State Corporate Income Tax Rates as of January 1, 2022

State	Brackets	Rate	State	Brackets	Rate
Alaska	>0	0%	Florida	>0	5.5%
	>25000	2%	Nevada [a]		GRT
	>49000	3%	New Hampshire	>0	7.6%
	>74000	4%	South Dakota [b]		None
	>99000	5%	Tennessee [a]	>0	6.5% + GRT
	>124000	6%	Texas [a]		GRT
	>148000	7%	Washington [a]		GRT
	>173000	8%	Wyoming [b]		None
	>198000	9%	Oklahoma	>0	4%
	>222000	9.4%			

Note. GRT stands for Gross Receipt Taxes (See special note [a]). Adapted from *Facts & Figures 2022: How Does Your State Compare? 2022* by Tax Foundation (2022), Table 14 (https://taxfoundation.org/wp-content/uploads/2022/03/Facts-Figures-2022-How-Does-Your-State-Compare.pdf). Copyright 2022 by Tax Foundation.

[a] "Nevada, Texas, and Washington do not have a corporate income tax but do have a gross receipts tax with rates not strictly comparable to corporate income tax rates. Tennessee has gross receipts taxes in addition to corporate income taxes" (Tax Foundation, 2022, p. 25). [b] South Dakota and Wyoming have neither a corporate income tax nor a gross receipts tax, but they may have special taxes on financial corporations instead (Tax Foundation, 2022, p. 27). For instance, South Dakota still collected $52 per capita in state and local corporate income taxes for fiscal year 2020, which is the second lowest amount per capita of all states that collected traditional corporate income taxes (Tax Foundation, 2022, Table 16). Meanwhile, Wyoming collected $0 per capita in state and local corporate income taxes in the same fiscal year (Tax Foundation, 2022, Table 16).

,

Table 3

Gross Receipts Tax Rates as of January 1, 2022

State	Name of Tax	Range of Rates
Nevada	Commerce Tax	0.051% - 0.331%
Tennessee	Business Tax	0.02% - 0.3%
Texas	Franchise (Margin) Tax	0.331% - 0.75%
Washington	Business & Occupation Tax (B&O)	0.13% - 3.3%

Note. Adapted from *Facts & Figures 2022: How Does Your State Compare? 2022* by Tax Foundation (2022), Table 17 (https://taxfoundation.org/wp-content/uploads/2022/03/Facts-Figures-2022-How-Does-Your-State-Compare.pdf). Copyright 2022 by Tax Foundation.

"Gross receipts taxes are complex business taxes imposed at a low rate but on a wide base of transactions, resulting in high effective tax rates that can vary by industry. These taxes also often have minimum taxes that can result in much higher effective rates for some small businesses" (Tax Foundation, 2022, p. 28). According to the Tax Foundation website, gross receipt taxes "Provide an advantage to businesses with high profit margins or considerable vertical integration, while they penalize companies with narrow margins or multiple transacted stages of production, [. . . and the effects of gross receipt taxes] can be particularly severe for startups" (n.d.).

,

Table 4

State and Local Sales Tax Rates as of January 1, 2022

State	State Rate (SR)	Avg. Local Rate	Combined Rate (CR)	SR Rank	CR Rank	Ranking Sum
New Hampshire [a]	-	-	-	46	47	93
Alaska [b]	-	1.76%	1.760%	46	46	92
Wyoming	4.00%	1.22%	5.220%	40	44	84
South Dakota [c]	4.50%	1.90%	6.400%	36	32	68
Oklahoma	4.50%	4.47%	8.970%	36	6	42
Florida	6.00%	1.01%	7.010%	17	23	40
Texas	6.25%	1.95%	8.200%	13	14	27
Nevada	6.85%	1.38%	8.230%	7	13	20
Washington	6.50%	2.79%	9.290%	9	4	13
Tennessee	7.00%	2.55%	9.550%	2	2	4

Note. For the columns, SR Rank and CR Rank, a higher rank out of fifty indicates a lower tax rate and vice versa. States are listed from highest to lowest according to the sum of their State Rate ranking and their Average Local Rate ranking. Adapted from *Facts & Figures 2022: How Does Your State Compare? 2022* by Tax Foundation (2022), Table 18 (https://taxfoundation.org/wp-content/uploads/2022/03/Facts-Figures-2022-How-Does-Your-State-Compare.pdf). Copyright 2022 by Tax Foundation.

[a] New Hampshire has "no state-level general sales tax" (Tax Foundation, 2022, p. 31). [b] "While Alaska does not have a state-level sales tax, it allows sales taxes on the local level" (Tax Foundation, 2022, p. 32). [c] South Dakota has a broader base for sales taxes than most other states, so its sales tax collections are not "strictly comparable to other states" (Tax Foundation, 2022, p. 31).

,

Table 5

Property Taxes Paid [a] as of Calendar Year 2020

State	Effective Tax Rate	Rank
Wyoming	0.56%	44
Nevada	0.60%	41
Tennessee	0.68%	36
Washington	0.88%	28
Oklahoma	0.88%	27
Florida	0.91%	26
Alaska	1.02%	21
South Dakota	1.18%	17
Texas	1.66%	6
New Hampshire	1.96%	3

Note. States are listed in order from highest rank to lowest rank. Adapted from *Facts & Figures 2022: How Does Your State Compare? 2022* by Tax Foundation (2022), Table 33 (https://taxfoundation.org/wp-content/uploads/2022/03/Facts-Figures-2022-How-Does-Your-State-Compare.pdf). Copyright 2022 by Tax Foundation.

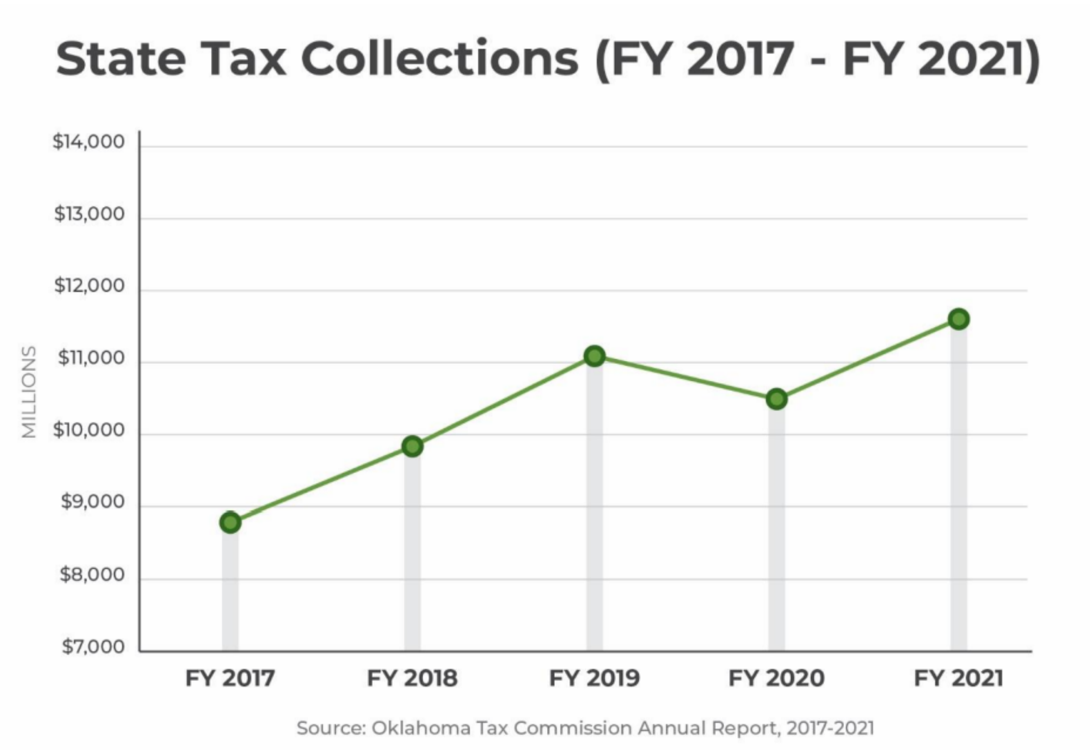
[a] "The figures in this table are mean effective property tax rates on owner-occupied housing (total real taxes paid / total home value). As a result, the data exclude property taxes paid by businesses, renters, and others" (Tax Foundation, 2022, p. 49).

,

Oklahoma Revenue Summary

Table 6

Oklahoma Revenue from State Tax Collections

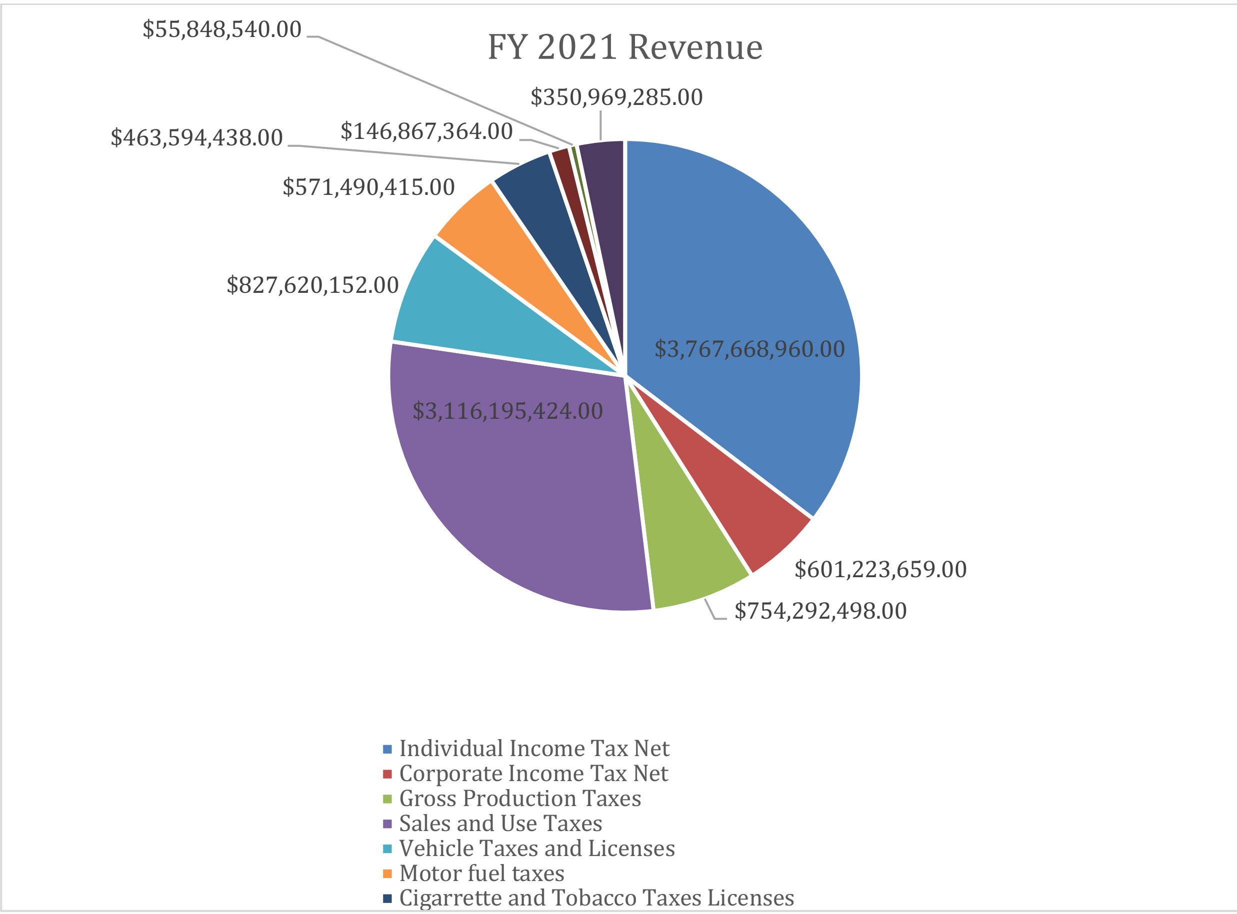


Note. Numbers on this graph include all tax, fee, and permit revenues collected by OTC and exclude city/county sales, use and lodging taxes. They also, by process, exclude amounts of tax preferences (deductions, exclusions, etc.) which are taken on income tax filings and are never collected

,

Table 7

Fiscal Year Revenue 2021



Oklahoma Tax Commission: Fiscal Year Ended June 30, 2021

Total of 2020 Income Tax Preferences = $1,647,605,315

Total of 2020 Sales Tax Preferences (Exemptions) = $1,007,824,259

Source: Oklahoma Tax Commission 2019-2020 Tax Expenditure Report - *Excludes sizeable exemptions and exclusions from sales taxes that are mostly uniform amongst states with a sales tax, such as "Sale for Resale" items.

,

Analysis and Recommendations

Oklahoma's income tax structure is based on an economy of the early 1900's. The old agriculture and manufacturing economy buttressed by oil and gas production has now become an economy driven by personal services resulting from the dominant sectors of energy, aerospace, technology, and health care. A much more efficient approach to taxation would be to completely shift to activity taxes based upon sales and services, and the elimination of taxes on production and income.

To leapfrog other states and join the top ten states in growth and migration fundamentally requires Oklahoma to become a no-income tax state, from a personal income tax perspective. The five guiding principles of tax policy are most adhered to by a no-income tax construct. To accomplish this difficult and challenging goal, legislative leaders would have to embark on the following:

1. Replace approximately $3,767,668,960. This number would be net of credits, deductions, and exemptions otherwise known as income tax preferences which are never collected.
2. The state sales tax of 4.5% would have to increase to approximately 9.95% under the current sales tax system to make up for the loss of personal income tax revenue.
3. The degree to which sales tax exemptions can be eliminated from the cost of $1,007,824,259 would allow for decreases of the before mentioned 9.95% rate. The elimination of $500,000,000 dollars of sales tax exemptions would decrease the 9.95% rate to a rate of 9.23%.

,

4. Additionally, to reduce the sales tax rate further, service activities that are specifically taxed in no-income tax states should be adopted in Oklahoma to target at least an additional $500,000,000 dollars in revenue to get the Oklahoma sales tax rate down to 8.5%. An in-depth comparative analysis on services taxed in the no-income tax states of Tennessee, Texas and Florida should be conducted. Of course, the broader the base of taxing services and activity, the lower the sales tax rate could be.
5. Most no-income tax states collect critical revenues from corporate income tax or gross receipts tax. Any reduction to the corporate income tax, including the recent decrease from 6% to 4%, impedes Oklahoma's path to becoming a no-income tax state. Tennessee, as documented above, has a 6.5% corporate income tax along with a gross receipts tax.

Given the political challenges to become a no-income tax state and the difficulties surrounding State Question 640, a different tax reform strategy could focus on the elimination of the state's sales tax on groceries, the elimination of the franchise tax, and the elimination of the corporate income tax. Additionally, reducing the income tax to 4.5% would certainly launch Oklahoma into a top-ten status of overall tax liability per capita. Keep in mind, however, that these tax liability per capita rankings do not account for gross production taxes, so consequently Oklahoma's low tax liability status is regularly overstated. Significant critique of Oklahoma's Financial management is it's failure to become a no-income tax state like other energy producing states such as Alaska, Texas and even South Dakota.

Oklahoma already has a low overall tax burden per person, so it must be noted that this has not facilitated significant population migration. Therefore, the above secondary strategy

,

would have less positive impact on population growth. It would, however, improve the states' Business Tax Climate ranking.

Considering the 2021 reductions in the personal income tax and the corporate income tax, these alternative tax cuts should be pursued in a mostly revenue neutral manner to maintain a stable revenue base that must now support higher pay for teachers, law enforcement officers, correction officers, and expenditure commitments to eliminate the DDSD waitlist. The strategy should consider these points:

1. Eliminating the sales tax on groceries would forfeit approximately $350 million. Eliminating the franchise tax would cost approximately $56 million. Eliminating the remaining corporate income tax would wipe out $396 million.
2. To offset the combined $802 million, a sizable portion of sales tax exemptions should be eliminated from the cost of $1,007,824,259 on the books. The advantage here is that the votes on such legislation only require a majority and not the 75% threshold required by SQ640 to raise taxes or begin a new tax.
3. A sizable amount of savings should also be pursued from the cost of the $1,647,605,31 of current income tax preferences. A notable tax expenditure item that does not align with the aforementioned tax policy principles is the Investment in Affordable Housing Tax Credit.
4. The Incentive Evaluation Review Commission has procured a cost benefit analysis for nearly every income tax preference, and their analysis and recommendations from the consultant, not necessarily the Commission's final actions, should be vigorously pursued.

,

Conclusion

The above information has clearly provided objective data that Oklahoma's tax code is not competitive enough to help Oklahoma be a top state for economic and population growth. Policy makers need to pursue meaningful tax reform to enable Oklahoma to reach a greater level of productivity and prosperity so more Americans fleeing high-tax states will consider and move to Oklahoma.

,

References

ALEC "The State Factor" July 2014

2022 ALEC – LAFFER State Competitiveness Report

Interview with Larry Kudlow on Kudlow, Fox Business News, May 2022

Oklahoma Tax Commission Annual Reports, 2017-2021

Oklahoma Tax Commission: FY2021 Revenue & Apportionment Report

Oklahoma Tax Commission 2019-2020 Tax Expenditure Report - *Excludes minimal and zero impacts, impacts that cannot be estimated and information that may not be disclosed.

Tax Foundation. (2022). *Facts & figures: How does your state compare? 2022*. https://taxfoundation.org/wp-content/uploads/2022/03/Facts-Figures-2022-How-Does-Your-State-Compare.pdf

Tax Foundation. (n.d.). *Gross receipts tax*. Retrieved June 23, 2022 from https://taxfoundation.org/tax-basics/gross-receipts-tax/

Wall Street Journal, June 3, 2022

Tax Foundation. (2022). *2022 State Business Tax Climate* https://files.taxfoundation.org/20220104110127/2022-State-Business-Tax-Climate-Index3.pdf

,