# rules of the game

*How to navigate the Arkansas tax and budget system*

ARKANSAS ADVOCATES FOR CHILDREN & FAMILIES

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# Why this report matters

People from all over the state – who have interests as varied as the counties from which they come – routinely ask us how they can make a difference. This question has several answers, but every one of them contains a common theme: learn about the tax and budget system. Understanding these basics provides you with the tools you need to be a great advocate for Arkansas's children and families.

Think of it this way: if you don't know how much money you have – or how you got any of that money in the first place! – you can't make good decisions about what groceries you can afford. If you don't understand how programs are funded, lawmakers will patiently listen to you explain the importance of a policy change, then tell you there isn't any money available to fund it. You need the tools to build strong arguments with lawmakers, and this guide will give you those tools.

This guide will teach you how to become a super-charged child advocate. Once you get the hang of it, you can then help others understand what you've learned. There's power in numbers, and together we can make the case for why all of Arkansas's children and families deserve the resources and opportunities they need to lead healthy, productive lives.

# Making choices

A budget is – at its most basic – a list of priorities. State governments must prioritize limited resources each year. They do this by identifying programs and systems that need public investment. As child advocates, we have a responsibility to make sure lawmakers – those that set and approve the budget – know where we want those investments to be made.

Are we going to spend our tax dollars on health care for hard-working people that still can't make ends meet? Or should we create tax cuts for extremely wealthy individuals and businesses? Should we invest in after-school and juvenile justice programs that keep kids safe, help working families, and inspire our children to learn? Or should we build more prisons? Do Arkansas's children deserve modern school facilities, pre-K programs that we know improve the outcomes of the state's future workers, and a level playing field regardless of whether a child is born in Blytheville or Bentonville? Or should we funnel taxpayer dollars to private or charter schools with little to no accountability for how those dollars are spent?

Failing to understand the budget process or actively share your priorities with legislators means you probably won't like the choices they make when it comes to these and other issues.

Each year the governor's office receives billions of dollars in budget requests. These requests come from state agencies charged with carrying out the people's work. They come from the state's biggest agencies like the Department of Human Services and the Department of Education on down to much smaller agencies. It takes money to run these departments and to fund the programs and services they administer. All of us should be concerned about where our tax dollars are sent and how they're spent.

The governor will draft a plan, but he and his team will not have final say on the various budget requests. The legislature holds the purse strings. It is up to the General Assembly to decide whether or not a program gets the funding it needs to serve Arkansas's children and families.

The rules of the game changed in 2013. Now the governor, administrators, and legislators must deal with new tax laws that impact how much money goes to whom. Lawmakers passed sweeping tax changes that will eventually cost over $140 million annually in lost state revenue in the budget beginning July 1, 2015. The vast majority of this money will go back to high-income earners and corporations. Next year those tax cuts will mean that state revenues will be substantially lower than previously expected. The state will miss out on $9 million, and that shortfall must be made up in other ways – either through reprioritizing the already-scant funds available for human service programs or eliminating services that money would normally go toward providing.

# How the budget affects the issues you care about

## EDUCATION

*No money, no programs*

Sometimes the connection between the issue that's near and dear to your heart and the state's budget is obvious. Pre-K funding provides a great example. The legislature has not increased funding for pre-K programs since 2008. That's five long years of inattention to what most education experts describe as the best investment we can make in our kids. Arkansas does a good job of enrolling eligible 4-year-olds, often ranking near the top of the National Institute for Early Education Research rankings. However, there are still far too many low-income kids, especially children younger than age 4, on the waiting list for high-quality pre-K programs that could improve their futures.

Pre-K is clearly an area where we can identify a specific link between the state budget and the issue: no money means no new programs, and a growing waitlist. Sometimes, though, that connection proves to be more elusive. The 2013 session gave us a great example of a state budget proposal that could have jeopardized funding for all kinds of issues – pre-K, K-12 education, infrastructure, higher education, public safety, and Medicaid to name a few. On the surface it looked like a simple highway funding issue, but it was much more than that. AACF and other groups called it the "Highway Robbery" bill. Several billion dollars in future state revenues would have been diverted away from things such as human services, education, and public safety and shifted solely to highways, thus doing an end-run around the traditional appropriations process.

While we certainly agree that our roads and highways are important to the state, we do not believe they are more important than programs that directly impact our children. So we launched a campaign against the bill, along with other groups including K-12 educators, two-year and four-year colleges, and other social justice advocates. After numerous attempts by the bill's sponsor to force the legislation through his committee, we finally beat it for good. This accomplishment took several groups all doing their best and working together to get it done – groups that understood that a highway budget issue had the potential to affect funding for their issues too.

## JUVENILE JUSTICE AND AFTER-SCHOOL PROGRAMS

*We were only asking for three!*

After-school programs give kids a place to go that keeps them active and engaged in learning, while helping working parents who might not be able to pick their kids up from school or provide adequate after-school care. Communities also see the added benefit of lower juvenile justice costs and reduced juvenile crime. If kids are in after-school programs, they aren't getting in trouble with the law and clogging up an already busy court system. In terms of money well-spent, afterschool programs are tough to beat. In 2011, the Arkansas General Assembly passed a law to establish quality after-school and summer programs across Arkansas. In 2012, the rules and regulations for that law were approved. Now, all the state needs to do is appropriate the money to get it up and going. And that would only take $5 million – about 0.01 percent of the state budget..

We asked lawmakers to set aside funding for these "shovel-ready" programs that benefit communities, save money, and reduce juvenile crime. That amount eventually got negotiated to $3 million – enough to get started, but not enough to sustain the programs. And then it went nowhere.

Once Speaker of the House Davy Carter announced plans for a $150 million tax cut package – that would mostly benefit the state's wealthiest citizens and corporations – there was just no more room for something like a $3 million after-school program.

Would you have made the same decision?

# The upside-down Arkansas tax structure

In order to be an even stronger budget advocate, you need to know where all this money comes from and how it gets into the state coffers. The obvious answer is that it comes from taxes. That, of course, is right, but there's a lot more to the story. We pay all sorts of taxes. In addition to our federal taxes, we also pay state income taxes, sales taxes, and excise taxes. Corporations pay income tax, franchise taxes, and unemployment taxes. And some industries – like oil and natural gas – pay severance taxes on the natural resources they take from the ground.

Understanding the types of taxes, where all the revenue originates, and who pays what taxes will make you a better advocate. The next few pages will help you get familiar with all of those things. The good news is that you don't need to be a tax policy expert to be an expert advocate. All you need to know are the basics.

Budget advocacy makes a huge difference in how the state spends our tax dollars. We have a responsibility to raise our voices and tell our lawmakers what we find important. They need to know that their constituents value child care, pre-K, after-school programs, and child welfare investigators. Without people voicing their priorities, lawmakers must use their judgment or turn to lobbyists for advice – if for no other reason than they didn't hear from you.

**Glossary**

*In order for readers to easily identify and define tax terms that will be used throughout this publication, glossary words will appear in boxes on the side of the page.*

# Understanding the basics

There are four key principles of a good tax system that you need to know. These core ideas will give you the foundation you need to understand tax policy.

## BALANCED

A good tax system is balanced. That means the tax base is broad enough so the state does not overly rely on any one source of revenue, especially if doing so places too much of the tax burden on one group of taxpayers. A balanced tax system creates stability. By relying more on predictable revenue sources than on those that can fluctuate wildly, such as lottery profits, lawmakers can more easily predict available revenue for the programs we all support.

## TRANSPARENT AND ACCOUNTABLE

Taxpayers need to be able to see where the state's tax dollars come from and how they are spent. Only then can citizens keep the government accountable. By allowing too many special exemptions and loopholes, the tax code is more difficult for the state to administer and for advocates to monitor. This leads to special interest giveaways at the expense of average tax payers.

## ADEQUATE

A good tax system should be able to generate enough revenue to support services that are critical to the well-being of children and families and the state's future growth. Annual expenses in government grow from year to year due to increases in both the cost of living and the size of the population. Our tax system needs to be able to keep up with the cost of growth while still allowing for new investments as times change.

## FAIR

A tax system should be based on families' or business' ability to pay. A tax system ceases to be fair when lawmakers ask low- to middle-income earners to shoulder a higher tax burden than wealthy corporations or individuals. Simply put, middle income earners should not be forced to spend a higher percentage of their income in taxes than high earners do.

REVENUE is government income collected through all means.[2]

The TAX BURDEN is the total amount of tax paid by a particular group of people or an industry, especially as compared to what other groups and industries pay.[3]

The TAX BASE is the amount subject to tax. If all consumers in a state purchased $1 million in coffee each year, then the tax base for coffee sales tax would be $1 million. However, the tax base does not have to be expressed in terms of money. If coffee were taxed by the pound, then the tax base would be the number of pounds of coffee sold.[1]

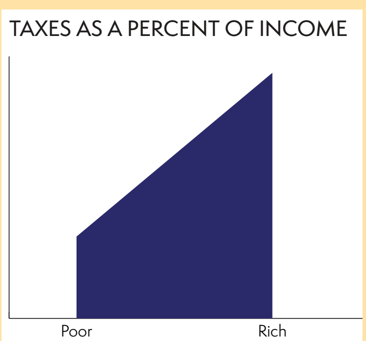
*What makes a tax system fair?*

To use industry jargon, a fair tax system is progressive, not regressive or proportional. Small businesses, low- and middle-income families, should not bear a disproportionate share of Arkansas's state and local tax burden. While no single tax can be "fair" to everyone, it is possible to create a system that is equitable overall.

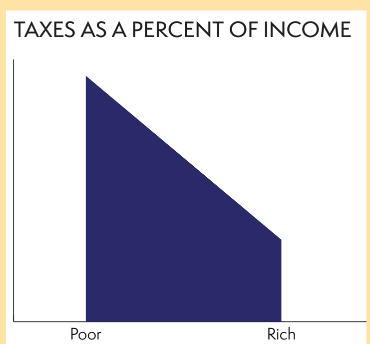
A good example of a progressive tax is the income tax. As a tax filer's ability to pay increases, so does his/her tax rate. Property taxes can also be progressive, as can certain types of sales taxes (such as on luxury items). General sales taxes, though, are the most regressive because low- and middle-income families spend more of their income on the basic necessities of life – items such as clothing, household and personal goods – which are subject to sales tax. [A]

Keep these principles in mind as you continue reading this guide. Remember, these are the four cornerstones of tax policy. Applying these principles to our state budget will help fund programs you care about and that strengthen our communities.

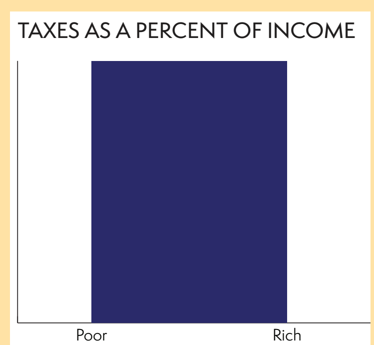
PROGRESSIVE taxes are a percent of a family's income. In a progressive system, low-income families pay a smaller rate than upper income families (ex: graduated income tax). As earnings increase, the tax rate increases.




REGRESSIVE taxes result in low-income families paying more of their income in taxes than upper-income families.




A tax in which all taxpayers pay the same is a called a PROPORTIONAL tax. (Example: a flat tax). A proportional tax system does not take into account a person's ability to pay.[4]



## Local property taxes: A special case

Nearly everyone pays some local taxes in addition to state and federal taxes discussed in this publication. For example, residents can vote for the city or county to levy sales taxes, which are collected by the state then sent to the city or county to use for their local needs, primarily K-12 education. Property taxes are much more complicated and contentious. Generally speaking, property taxes are levied at a fixed rate of $0.001 (or one mill) per $1,000 of assessed value (ad valorem) of a person's or business's property. Even if you don't own a house, you may indirectly pay your landlord's property tax through a portion of your rent. Since housing represents a much higher percentage of low-income families' budgets, property taxes tend to be slightly regressive.

Arkansas has a low average property tax rate compared to states across the country. Nevertheless, voters led a "tax revolt" in 2000 and passed Amendment 79. It created a five percent cap on yearly property tax increases and gave a $300 homestead tax credit (a tax break that was raised to $350 in 2007) to help offset homeowners' rising property taxes. Renters, who are usually low- and middle-income, are not eligible for the credit.

Source: "Rules of the Game: An Advocates Guide to the Arkansas Tax and Budget System" www.aradvocates.org/assets/PDFs/Advocates-Guide-FINAL-WEB.pdf

A MILL is the amount of tax payable per dollar of the assessed value of a property. The rate is based on "mills"; as each mill is one-thousandth of a dollar.[5]

A property's ASSESSED VALUE is the official value of a property for tax purposes, as determined by property tax officials. A property's assessed value can be equal to its market value, or less than market value, depending on the legal assessment ratio used by the state and the quality of the assessments.

An AD VALOREM TAX is a tax based on the value of the things being taxed. Sales taxes are based on the sales price of items being taxed, so they are ad valorem taxes.[6]

# Does Arkansas's tax system satisfy our four key principles?

Arkansas has a long way to go to make our tax system balanced, transparent, accountable, adequate, and fair.

## ARKANSAS'S TAX SYSTEM IS UNBALANCED

Arkansas's tax system relies too much on the sales tax and not enough on other sources of revenue that would more fairly spread the tax burden to all taxpayers. In addition, our state relies less and less on taxes paid by corporations, meaning our budget must be increasingly funded by low- and middle-income individuals and families.

Why is Arkansas's system so unbalanced? For one thing, Amendment 19 of our state Constitution (sometimes called the "The Futrell Amendment" after the measure's sponsor) was passed in 1934 to require that any increase in taxes that were in place at the time must be approved by a supermajority vote by the legislature. Since both the progressive personal and corporate income taxes were in effect in 1934 and require a supermajority vote to be increased, it is extremely difficult to find enough legislators willing to raise them now. More regressive taxes such as the sales tax require only a simple majority vote in order to increase. Therefore, the Legislature almost always raises revenue by increasing the sales tax.

SUPERMAJORITY VOTES require at least 75 percent of the Legislature to be passed. This means 27 votes in the Senate and 75 votes in the House.

SIMPLE MAJORITY VOTES require at least 50 percent of the Legislature in order to pass.[7]

### Amendment 19 vote requirements for tax rate increases

| *Taxes Requiring 51% (simple majority)* | *Taxes Requiring 75% (supermajority)* |
|---|---|
| General Sales Tax (1935) | Local Property Tax (1874) |
| Compensating Use Tax (1949) | Corporate Income Tax (1929) |
| Real Estate Transfer Tax (1969) | Individual Income Tax (1929) |
| Tobacco Products Tax (1969) | Motor Fuel Tax (1921) |
| Wine & Liquor Gallonage Taxes (1935 | Diesel Fuel Tax (1921) |
| L.P. Gas Special Fuel Tax (1965) | Cigarette & Cigar Tax (1929) |
| Alcohol On-Premise Consumption (1969) | Slot & Vending Machine Tax (1931) |
| Estate Tax (1941) | Severance Taxes (1923) |
| Beer Excise Tax (2001) | Beer Gallonage Tax (1933) |
| | Inheritance Tax (1909) |

TAX EXPENDITURE REPORTS are itemized listings of revenue that would be lost through providing tax breaks. They show how the cuts would affect the state's budget in the same way as spending would.[8]

## ARKANSAS'S TAX SYSTEM SHOULD BE MORE TRANSPARENT AND ACCOUNTABLE TO TAXPAYERS

Tax expenditure reports can help the public understand where their tax dollars come from and where they go. Arkansas publishes a tax expenditure report, but it is viewed as one of the least helpful published by a state because "they omit major taxes, fail to provide cost estimates and other key information for many tax expenditures, and/or are not available on-line."[B]

These reports are important for tax and budget transparency and accountability because corporations are quite good at lobbying for tax exemptions in the budgeting process. Tax cuts are also given to corporations in the form of economic development incentives that come with little transparency or accountability for generating jobs and the economic growth they promise. The Department of Finance and Administration (DFA) must release fiscal impact statements on each tax bill introduced by the legislature. This information is provided on the Arkansas Legislature's website with the bill, but often too late for advocates to influence the Legislature's decisions by the time the statement is created.

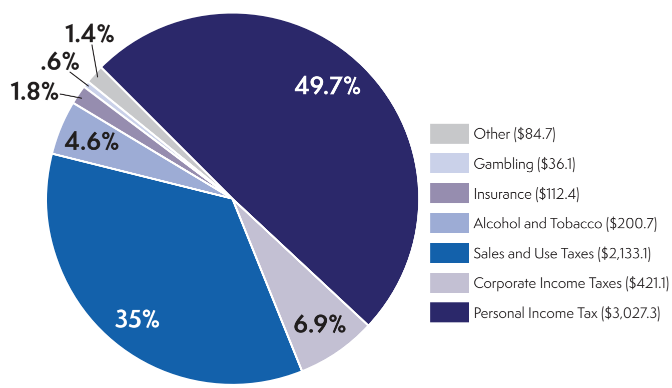
According to the Corporation for Enterprise Development (CFED), an ideal tax expenditure report contains features such as a tax incidence analysis, a list of enacting statutes and multi-year data.

Another area of concern is local property taxes, which have often been inequitably assessed and collected by government officials and evaded by many taxpayers and businesses (who must pay business personal property tax on things like manufacturing or farm equipment). Therefore, our state government has to fund more and more of the cost of local schools even though a large percentage of local property taxes in Arkansas are dedicated to schools. **These are all areas in which advocates can start working to ensure greater tax and budget transparency and accountability.**

During the 2011 legislative session, the Arkansas Open Checkbook Act was passed. This law created a website that allowed users to view expenditures, revenues, state employee salaries, bonded debt, contracts, and payments. It was designed to allow the public to have a greater look into the state's budget, however it does not allow taxpayers to track tax breaks or show what the state's return on investment is for those breaks. To view Arkansas' Open Checkbook website, visit transparency.arkansas.gov.

TAX INCIDENCE ANALYSIS is the measure of the impact of various taxes on residents at different income levels.[9]

ALL STATE GENERAL REVENUE
Fiscal Year 2013, in millions




*Source: "General Revenue Forecast Years 2013 and 2014" Department of Finance and Administration, May 2013*

## ARKANSAS'S TAX SYSTEM FAILS TO GENERATE ADEQUATE REVENUE TO SUPPORT CRITICAL SERVICES

According to a 2006 study by the Urban Institute and Brookings Institution's Tax Policy Center and the Federal Reserve Bank of Boston, Arkansas is ranked next to last in the country in terms of our ability to provide the level of services our population needs given our higher level of poverty.[C] This problem grows worse over time, as state revenues fail to keep up with the rising cost of providing public services – a problem known as a structural deficit.

## ARKANSAS'S TAX SYSTEM IS DEFINITELY NOT FAIR – IN FACT, IT'S ONE OF THE MOST REGRESSIVE IN THE COUNTRY

Overall Arkansas families making below $44,000 pay nearly 12 cents for every dollar they earn in state and local taxes compared to just under six cents on every dollar paid by the top one percent of earners (those making more than $311,000).[D] The charts on page 20 illustrate the regressive nature of our tax system. Some large corporations receive favorable treatment under Arkansas's tax system, putting small businesses at a competitive disadvantage.

A state with a STRUCTURAL DEFICIT has failed to collect sufficient revenue to grow as quickly as the cost of services and programs during healthy economic times. Structural deficits can be attributed to out-of-date tax systems with costs that rise faster than the economy in areas like health care or education.[10]

## Advocates made it happen

During legislative sessions between 2007 and 2011, the Legislature made changes that made our tax system more progressive.

- The state has worked on cutting the grocery tax from six percent to zero if certain fund balances are met. (Act 1450 of 2013).
- Act 736 of 2011 provided income tax relief to all Arkansas families at or below the federal poverty line.

However, the 2013 session saw a dramatic political shift from helping low- and moderate-income families to cutting taxes for high-income earners and some industry groups and inadequately funding a number of vital programs that would benefit everyday Arkansans. This political shift is likely to continue for the next few years. That means advocates need to get more involved in the tax and budget process to ensure that vital programs are maintained and expanded and that low- and middle-income families do not take on the lion's share of our state's tax burden.

# Where does the state's money come from?

CAPITAL GAINS is the income earned from the sale of assets like stocks, bonds or real estate.[12]

Arkansas's multi-billion-dollar budget comes from a variety of sources, which helps protect the state from huge swings in revenue from any single source from year-to-year.

*Personal Income Taxes*

Arkansas's primary source of general revenue (49.7 percent) comes from the state's personal income taxes. These are the taxes withheld from our paychecks each month.

Our personal income tax system is considered progressive because as a tax filer's income rises, so does their tax rate. The Arkansas personal income tax system has six levels of taxation which are graduated from one percent to 6.875 percent starting January 1, 2014. More changes will be made to the personal income tax beginning January 1, 2015, when additional tax rates will decrease in accordance with Act 1459 of 2013.[E] Also in 2015, the standard deduction for Arkansas taxpayers will increase from $2,000 to $2,200.[F] This means low- and middle-income filers will automatically be able to reduce their taxable income.

Arkansas's income tax system has improved for low-income families and individuals in recent years. Act 736 of 2011 ensured state income tax relief was provided for all families and individuals who qualify for the low-income tax credit. This means all Arkansans living at or below the federal poverty line can keep more of their hard-earned money in their pockets in order to pay for basic necessities.[G]

Taxes have been cut for high-income and wealthy taxpayers. Arkansas allows a tax exemption on 30 percent of any capital gains earned by Arkansas taxpayers. That means anyone with a capital gain gets 30 percent of that income completely tax free.  In two years this tax exemption will increase to 50 percent in accordance with Act 1488 of 2013.These types of tax exemptions almost exclusively benefit high-income earners because very few low- or middle-income Arkansans will ever see a capital gain.

Considering tax reform without first considering the many taxes Arkansans pay leads to reckless decision making. Lawmakers have historically pointed to the personal

GRADUATED TAXES apply higher tax rates to higher income levels. Most income taxes use graduated rate structures.[11]

**Arkansas' Graduated Income Tax**
*(as of January 1, 2014)*

| | |
|---|---|
| $0 - $4,099 | 1.0% |
| $5,000 - $8,199 | 2.5% |
| $8,200 - $12,199 | 3.5% |
| $12,200 - $20,399 | 4.5% |
| $20,400 - $43,999 | 6.0% |
| $44,000 and up | 6.875% |

income tax, pledging to cut or raise the tax based on their point-of-view. In truth, though, the personal income tax rate in Arkansas already falls in the middle of rates nationally. According to the U.S. Census Bureau (see chart below) Arkansans enjoy an extremely low personal property tax rate while paying an enormously high sales tax rate. Texans may pay no income tax, but they pay twice as much in property taxes than Arkansans pay.

In the end, states will find a way to collect the tax revenue they need to fund shared services. The trick is to find a way to make a tax code fair and equitable. As you can see in the chart below, Arkansans trade an average income tax ranking for a Top Ten sales tax ranking. AACF believes this is an unfair tax code because it asks low- and middle-income earners to pay a higher percentage of their incomes in taxes than those at the top end of the income scale.

## Arkansas tax rates compared to other states

| | Own-Source General Revenue | | Personal Income Tax | | Corporate Income Tax | | Property Taxes | | General Sales Tax | | Selective Sales Tax | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | *Amount* | *Rank* | *Amount* | *Rank* | *Amount* | *Rank* | *Amount* | *Rank* | *Amount* | *Rank* | *Amount* | *Rank* |
| Arkansas | 15.2% | 30 | 2.3% | 22 | 0.4% | 17 | 1.9% | 47 | 3.89% | 6 | 1.4% | 17 |

*Sales and Use Taxes*

Sales taxes are the most regressive of all taxes and account for the second largest (35 percent) source of revenue for Arkansas. Most of this sales tax revenue comes from the six percent general sales tax on tangible goods, like clothes – ranking Arkansas as having one of the highest sales tax rates in country. The rest comes from "selective sales taxes," or excise taxes. (Taxes on alcohol and tobacco make up 4.6 percent of state general revenue.)

Not everything we buy is taxed thanks to many tax exemptions passed by the legislature each session. In fact, Arkansas's tax base is relatively narrow. Many services (such as attorney fees or lawn care) are excluded from sales tax, which tends to benefit large corporations and high-income individuals and families. Similarly, the Arkansas sales tax also fails to reach a range of items purchased online, such as software, music, movies, books, and other goods delivered on the internet.

USE TAXES are a sales tax that applies to goods that are purchased from out-of-state retailers.

EXCISE TAXES are sales taxes that apply to particular products. For example, many states have an excise tax on alcohol, cigarettes and gasoline. These taxes have many times been referred to as "sin" taxes or "luxury" taxes.[13]

NET INCOME is a company's total profit or earnings minus the costs of doing business. This is often called a company's "bottom line." [14]

### *Corporate Income Taxes*

A progressive tax, the corporate income tax (CIT) is based on the percentage of a corporation's net income. It mostly affects residents of other states who are the owners and shareholders of large corporations in Arkansas that are being taxed. Very few Arkansas-based corporations pay their full tax.

In Arkansas, the top marginal tax rate for corporations is 6.5 percent, yet their effective rate (the taxes they actually pay) is usually much lower thanks to the following reasons: the top rate of 6.5 percent only applies to net income over $100,000 while income less than that is taxed at a series of lower rates - corporations can qualify for credits and exemptions that reduce the income that may be taxed - and there are loopholes written into the tax code that allow larger corporations to avoid paying taxes by shifting some of their profits to other states with lower or no corporate income taxes. The share of state tax revenue from CIT has shrunk considerably over the past 35 years (from 31 percent in 1978 to just below seven percent in 2013). As a result the state must rely more on taxes from individuals and families to pay for vital public services and programs, despite the fact that out-of-state corporations rely on Arkansas roads, public safety systems, and public education system to do business.[H]

### *Other State Taxes and Fees*

The final sliver of the state's general revenue (two percent) is made up of taxes on miscellaneous things like gambling, severance taxes on the extraction of natural resources, taxes on life insurance premiums, real estate transfer taxes, corporate franchise fees, and user fees for things like camping in a state park. Many of these taxes are dedicated to fund specific projects or programs.

The MARGINAL TAX RATE is the rate applied to income over the amount where each bracket starts. For example, the highest rate (6.5 percent in Arkansas) only applies to the money earned above $100,000. So if a company earns $100,001 they only pay that highest rate on the $1. This prevents someone's entire income (or a corporation's income) from being taxed at the highest rate.

The EFFECTIVE TAX RATE is the tax actually paid as a share of the potentially taxable base. For example, the effective income tax rate is the income tax paid expressed as a share of total personal income.[15]

# Putting it all together

FICA payroll taxes are paid by both employers and employees to fund Social Security and Medicare.[16]

All of those state taxes combine with other revenue sources – confused yet? – to create the state's overall budget. Don't worry. We're here to explain.

This fiscal year the state's overall budget comes to a grand total of almost $25 billion. The state legislature ultimately approves spending just under 20 percent of that amount for state services. The rest of the money comes from federal funds, dedicated taxes, and cash reserves. You can see this break down in the graph on page 19.

## STATE GENERAL REVENUE

*20 percent of all revenue*

State general revenue comes from all of those state taxes we just identified and funds most public services, such as education and public safety. The state legislature has a great deal of discretion over how to spend these funds. This is where advocates can get involved in order to expand existing programs or create new ones.

## FEDERAL FUNDS

*29 percent of all state revenue*

In addition to state taxes, all working families pay some kind of federal taxes, such as social security or Federal Insurance Contributions Act (FICA) payroll taxes, or federal excise taxes on gas and cigarettes. The federal government pools this money then sends much of it back to states for various uses, such as Title I funding for low-income students in public schools. Federal funds constitute Arkansas's second largest source of revenue. These funds help offset our lower-than-average salaries and tax revenue in Arkansas relative to other states.

While the state legislature has no discretion over how these funds are used, advocates can still work with legislators to appropriate enough money for the state to receive federal matching funds. For instance, much of the Medicaid money Arkansas receives (as of Fiscal Year 2013) can be matched 2.34 to one.[I] In other words, for every dollar the state spends on Medicaid, the federal government will give us $2.34 to spend.

MATCHING FUNDS are the money that the federal government often requires the state to provide in order to receive federal dollars.

DEDICATED REVENUES cannot be redirected by the state legislature.

## SPECIAL REVENUE

*5 percent of all state revenue*

Special revenue comes from taxes and fees that are designated for a specific purpose under either the state Constitution or state law. For example, revenue from the motor fuel tax and vehicle license fees goes towards building roads. In 1996, the state also enacted Amendment 75 which created a 1/8-cent sales tax to help fund certain agencies such as the Arkansas Game and Fish Commission, the Department of Parks and Tourism, the Department of Heritage, and the Keep Arkansas Beautiful campaign. As with federal funds, the state Legislature does not have any say about how special revenue is spent.

## CASH FUNDS AND OTHER REVENUE

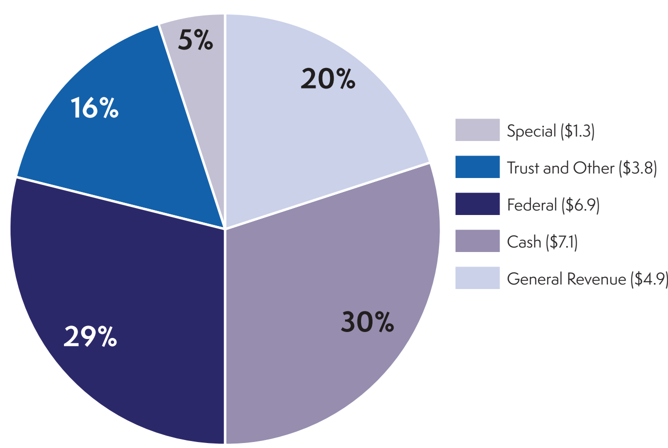
*46 percent of all state revenue*

The rest of the state's revenue comes from cash funds and non-revenue receipts. This accounts for liquid assets held by the state, revenue generated from the state renting property to private entities, and any other revenue not generated through taxes. These funds generally have specific purposes and are not subject to legislative appropriation.

CASH FUNDS come from the interest the state earns on investments or from things like college tuition fees.

Money from NON-REVENUE RECEIPTS is income the state earned for providing certain services, like renting a state facility.[17]

ALL STATE AND FEDERAL REVENUE IN ARKANSAS
Fiscal Year 2013, in billions

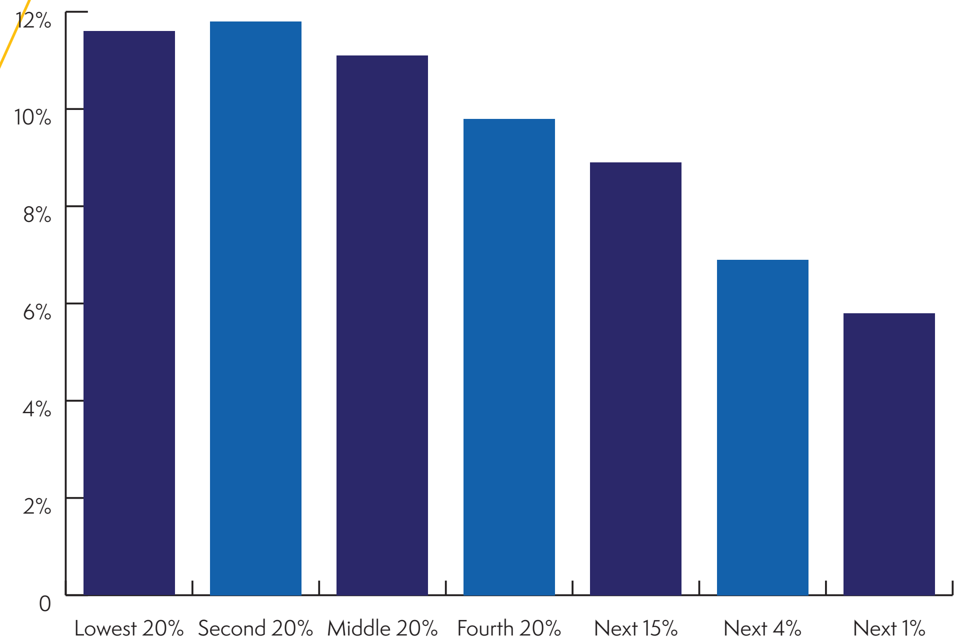



*Source: "Selected Statistical Financial Data for Arkansas" Bureau of Legislative Research, October 2012*

# Breaking down the tax burden

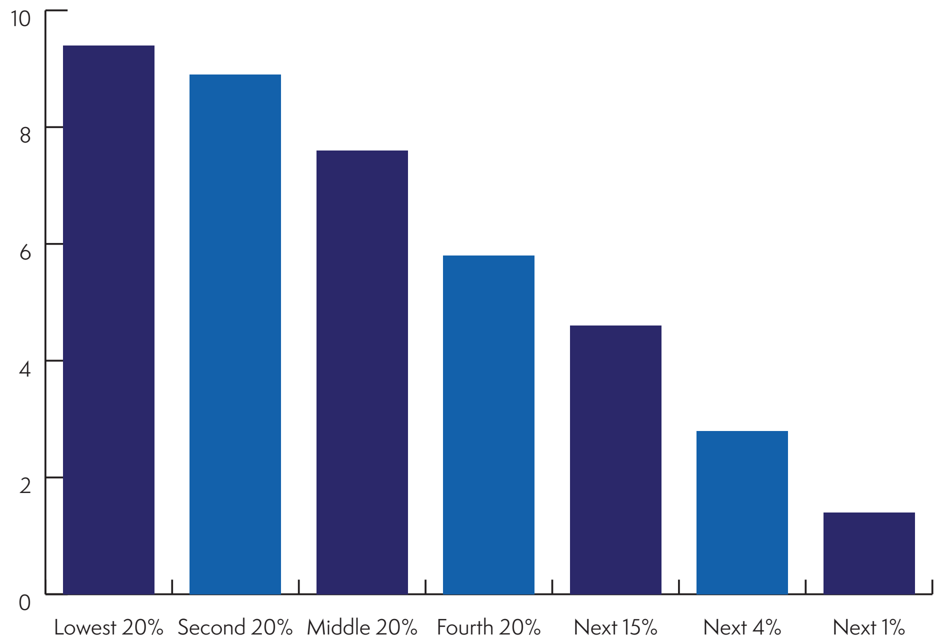
As you can see in each of these charts, families with lower incomes pay a higher percentage of what they earn in taxes.

ARKANSAS STATE AND LOCAL TAXES AS PERCENTAGE OF FAMILY INCOME



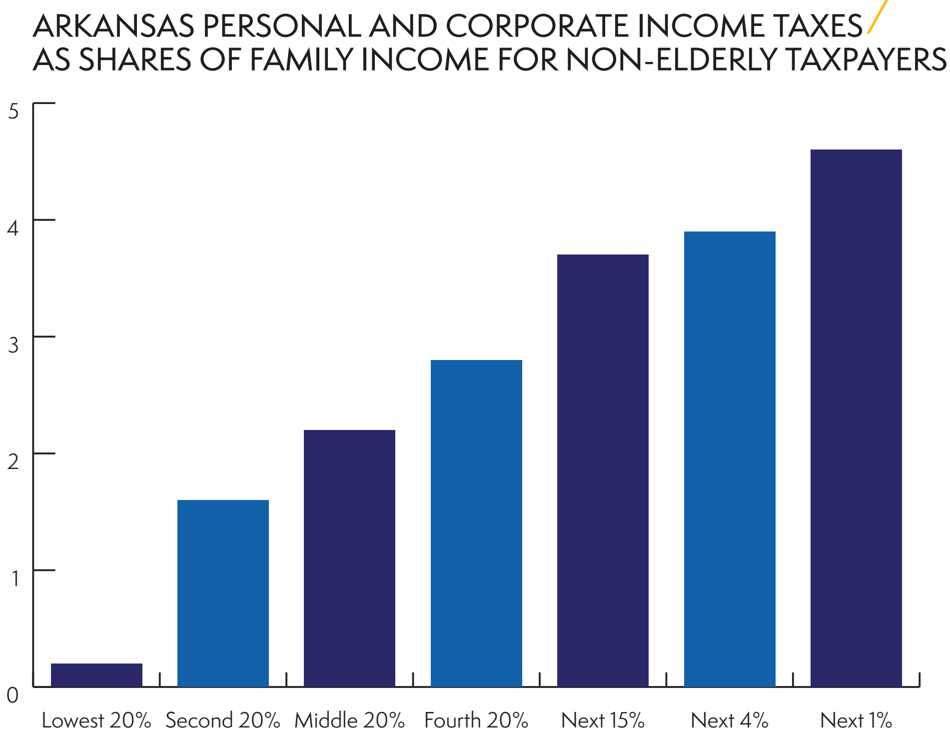

*Source: Institute on Tax and Economic Policy, 2013*

ARKANSAS SALES AND EXCISE TAX AS SHARES OF FAMILY INCOME FOR NON-ELDERLY TAXPAYERS

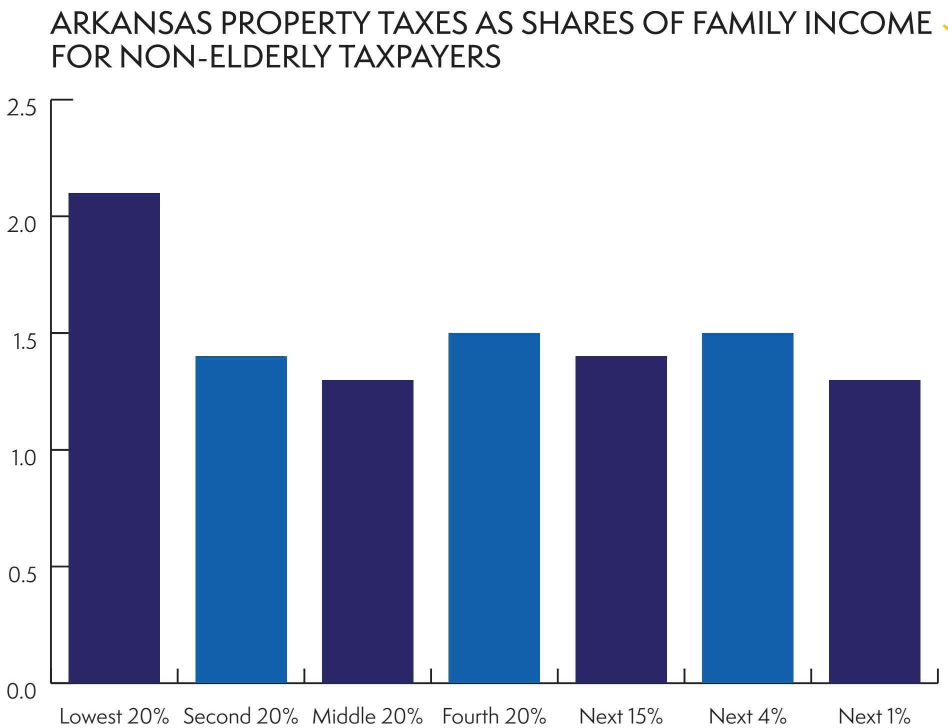



*Source: Institute on Tax and Economic Policy, 2013*

Personal income and corporate taxes are actually progressive, with those who can afford it paying more.




*Source: Institute on Tax and Economic Policy, 2013*




*Source: Institute on Tax and Economic Policy, 2013*

The lowest 20 percent of earners pay more in property taxes. Other income groups pay roughly the same amount.

# The state budget: Pooling our resources for the common good

When you create a budget for your family, you are essentially making a statement about your family's top priorities and values. The things you want, such as going on vacation or buying a new flat-screen TV, probably don't get funded until you can meet your needs, such as food, shelter, and clothing – and when times are tough, there may not be enough money to pay for those things.

Our state government must make tough choices about what to spend our tax money on and in what proportion. As the cost of providing public services rises along with inflation and the growing needs of our population, our government must also decide where more money should come from or which services should be cut. While the process is similar, government budgeting is far more complex than what families face. Among other things, families don't have to worry about funding public schools, paying for roads, or keeping criminals off our streets.

So where does our tax money go? Eventually it's made available to state agencies to spend on a wide range of services that benefit all Arkansans. Before that occurs, however, some of the money that is collected is taken off the top for items such as tax refunds, claims against the state, constitutional offices, and a few other things. After these "off the top" items are paid for, the money is then distributed to state agencies that provide many of the services that Arkansans depend on, such as education, health care, public safety, etc. (See the Appendix.)

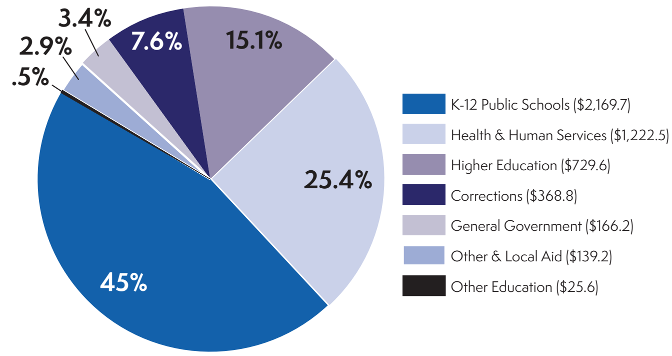
Most general revenue goes toward education and health care, whose costs will continue to increase faster than our current revenue streams into the future.

Battles over state spending are typically fought at the margins – and long before the legislative session even begins. Policymakers' discretion over spending is limited by earmarked taxes, the prohibition against deficit spending, restricted use of federal funds, and obligations to pay interest on loans, retirement funds, and other programs, such as education. Budget increases are usually incremental with expenditures only varying slightly from year to year. For these reasons, advocates must begin working toward funding increases very early, and for a

## Lake View

A series of state court rulings named for the former Lake View School District ultimately declared the state's public school system inadequate under the state constitution and ordered the state to improve school funding. Act 108 of 2004, nicknamed the "Doomsday" legislation, now requires that spending on K-12 education must have first priority in the state's budget, even if other critical programs must be cut. Despite massive funding increases since 2004, the state still lags behind the national average in K-12 per-pupil spending and achievement, and it still has a long way to go to ensure that all children are given the necessary opportunities to learn.[18]

GENERAL REVENUE EXPENDITURES, FY 2013 (in Millions)




Source: "Selected Statistical Financial Data for Arkansas," Bureau of Legislative Research, October 2012

long time, and cannot expect major changes overnight. It takes great patience to achieve major legislative victories.

*K-12 Public Education*

Education is the state's top funding priority, with the largest share of the state's budget going to public schools. The state collects local property taxes from counties, then uses a funding formula to provide a base level of money to local school districts in an equitable and adequate manner, as mandated by the state Constitution. Federal funds combine with state and local dollars to ultimately make up the budget each school district must administer. The Lake View court rulings have ensured that public education remains a top priority for the state through the budgeting process.

Districts also receive additional "categorical" funding based on their number of low-income students eligible for free or reduced-priced lunches under the federal National School Lunch Act, students with limited English proficiency, and other special needs.

For more information on how public schools are funded, see "A Citizen's Guide to Arkansas Public School Financing" at www.aradvocates.org/assets/PDFs/K-12-Education/Citizens-Guide-to-Public-Education-Press-Quality.pdf.

*Health and Human Services*

Last year (fiscal year 2013) the state is estimated to have spent more than $1.2 billion on health and welfare programs such as ARKids First, hospitals, research facilities, and county health units.

*Higher Education*

The state spent nearly $730 million dollars on public universities and colleges in Fiscal 2013 (approximately 15 percent of the state's budget).

*Other Education Spending*

In addition to K-12 public education, the state also commits funds to specialized state education facilities each year like the Schools for the Blind and the Deaf and public libraries.

*Corrections*

Approximately eight percent of the state's general revenue went to prisons in Fiscal 2013.

*"Other" Expenditures*

There are many other state expenditures that do not fit into the categories above, including the administration of state government (example: the judiciary and dozens of state agencies) and public safety agencies. The state also "turns back" a significant amount of tax dollars to local governments the same way that the federal government returns tax dollars to the state.

# How does the budget get created?

The BASE LEVEL is the minimum amount needed to maintain the current level of services and programs.[19]

Arkansas's fiscal year begins on July 1 and ends on June 30 of the following year. The budget process goes through the following stages:

1. The Governor issues a policy letter as early as April. This statement sets a base level for state spending in the next budget.

2. State agencies then request money for the upcoming fiscal year. In June or July, state agencies may request funding above the governor's base by presenting a "change level request" to the Department of Finance and Administration's (DFA) Office of Budget, which compiles and analyzes the requests and presents them, along with revenue projections, to the governor. The amount of general revenue that state agencies can spend depends on DFA's forecast of how much revenue the state should receive in the upcoming fiscal year(s), based on the economy, unemployment data, and other factors. Advocates should be prepared to present their own recommendations to state agencies very early in the process.

3. The governor's office then makes its own recommendations by August and holds executive budget hearings with state agencies from September to December. The governor presents his comprehensive state budget proposal by November. Legislative staff has little time to review budget proposals from the executive branch before the legislative hearings officially begin.

4. The budget process then moves to the Legislature.
   - October to December – The Legislative Council and Joint Budget Committee hold their own joint budget hearings to approve the appropriation level for each state agency. Meanwhile, the Bureau of Legislative Research releases a thorough manual of the governor's proposed budget for the Legislature to consider when the General Assembly convenes.
   - November – By law, DFA's Office of Economic Analysis and Tax Research must release the state's general revenue forecast for the next fiscal year at least 60 days prior to the legislative session. This forecast is used as a basis for determining how much general revenue will be available to fund state government programs.
   - January of odd-numbered years – When the legislature convenes for the regular session (on the second Monday in January) the Joint Budget Committee introduces the appropriation bills for consideration by the full Legislature. Article 5 of the state constitution requires that a

## What is a GIF?

Any budget surplus (money left over after all spending needs are met) can go into the General Improvement Fund (GIF), which is typically used for one-time construction projects or other major capital expenditures. In 2006, the state Supreme Court ruled that projects that did not benefit the state as a whole violated the ban on local "pet projects" in Amendment 14 of the state constitution. Although legislators still file hundreds of GIF bills for different agencies and programs each legislative session, not all are actually funded. The Legislature now shifts more surplus funding into "turn-back funds" that are redistributed to local governments to spend however they wish.

An APPROPRIATION BILL is a legislative act that proposes the authorization of an expenditure of public funds for a specific purpose.[20]

## Fiscal legislative sessions

In 2008, Arkansas voters approved a constitutional amendment that requires that the Legislature meet every year. Regular legislative sessions begin in January of odd-numbered years. These sessions can cover any topic. Fiscal sessions take place in odd-numbered years and can only cover the budgets of the "big six": the Department of Education Public School Fund Account, Institutions of Higher Education, Department of Human Services, Department of Health, Department of Corrections and the Department of Community Correction. A two-thirds vote is required to consider any other bills during the fiscal session. After two budget sessions, additional bills have yet to be considered.

separate bill be filed for each subject area, which results in over a thousand bills being introduced to the Committee (compared to anywhere from one to five in most states). During the session, the Committee and its numerous subcommittees meet daily to hammer out the details of the budget.

- February of even-numbered years – Fiscal sessions begin on the second Monday of February to consider the six major state department budgets.
- January to April – All budget bills must receive a "do pass" vote from the Joint Budget Committee before the legislature can vote to approve them. Each time a tax bill is amended, DFA must issue a new revenue impact statement and the bill must be reconsidered by the committee.

As with many tax increases described early in this guide, the constitution requires a supermajority (three-fourths) vote by the legislature on most appropriation bills as well. The precise dollar amounts in these bills are often highly controversial and prompt fierce pressure and bargaining among legislative bodies and individual legislators. But because these negotiations tend to be private and conclusive, most budget bills pass the full chambers unanimously.

## KEEPING THINGS STABLE

Unlike the federal government, our state government must have a balanced budget each year. This prohibits state agencies from spending beyond their means. Passed in the Great Depression, Amendment 20 effectively prohibited state debt, and the Revenue Stabilization Act of 1945 created a formal budgeting process which is largely still in place today. When state revenue is down, spending must also go down. This is always unpleasant but protects us from gathering a mountain of debt. States like California have often cited Arkansas's budgeting process as a model for fiscal responsibility.

The Revenue Stabilization Act prioritizes the general revenue budget by three categories (and sometimes sub-categories) of spending:

- Category A: These allocations get top priority in the budget.

- Category B: This category lists programs that can be funded if there is enough revenue available.

- Category C: This category is a "wish list" of things that can be funded if there is really growth in revenue. Since this doesn't happen very often, programs in Category C are seldom funded.

At the end of the legislative session, lawmakers cast their final votes on the budget for the next fiscal year.

## Key legislative committees

**Joint Budget Committee:** This is a bi-chamber (House and Senate) committee that meets almost every morning during the legislative session. The committee has two co-chairs, a House member and a Senate member. All appropriation bills come out of this committee before they receive consideration by full chambers. The committee has responsibility for developing the state budget. Members also develop and pass the Revenue Stabilization Act, the major piece of budget legislation.

A key subcommittee is the **Special Language Sub-Committee**. This is where many of the deals are cut and the language for special budget mandates is developed.

**House and Senate Committees on Revenue and Taxation:** These committees pass nearly all tax legislation.

**House and Senate Committee on Agriculture and Economic Development:** Measures that grant tax breaks for economic development subsidies sometimes go through this committee instead of the Revenue and Taxation committees.

# How advocates can shape the state's tax and budget system

## How to send a message to your legislator

ON THE HOUSE OR SENATE FLOOR

*When the House and Senate are in session at the Capitol, you can still gain access to your senator and representative by going to the chamber doors. At the desks, fill out the slips of paper that will ask you who you would like to speak to and give the paper to the people in red coats. The "pages" (legislative assistants) will then take these to your legislator. If they are able to meet with you they will come out to the area where you are. They may not be able to meet you at that time, but they will send you a slip of paper back with an explanation.*

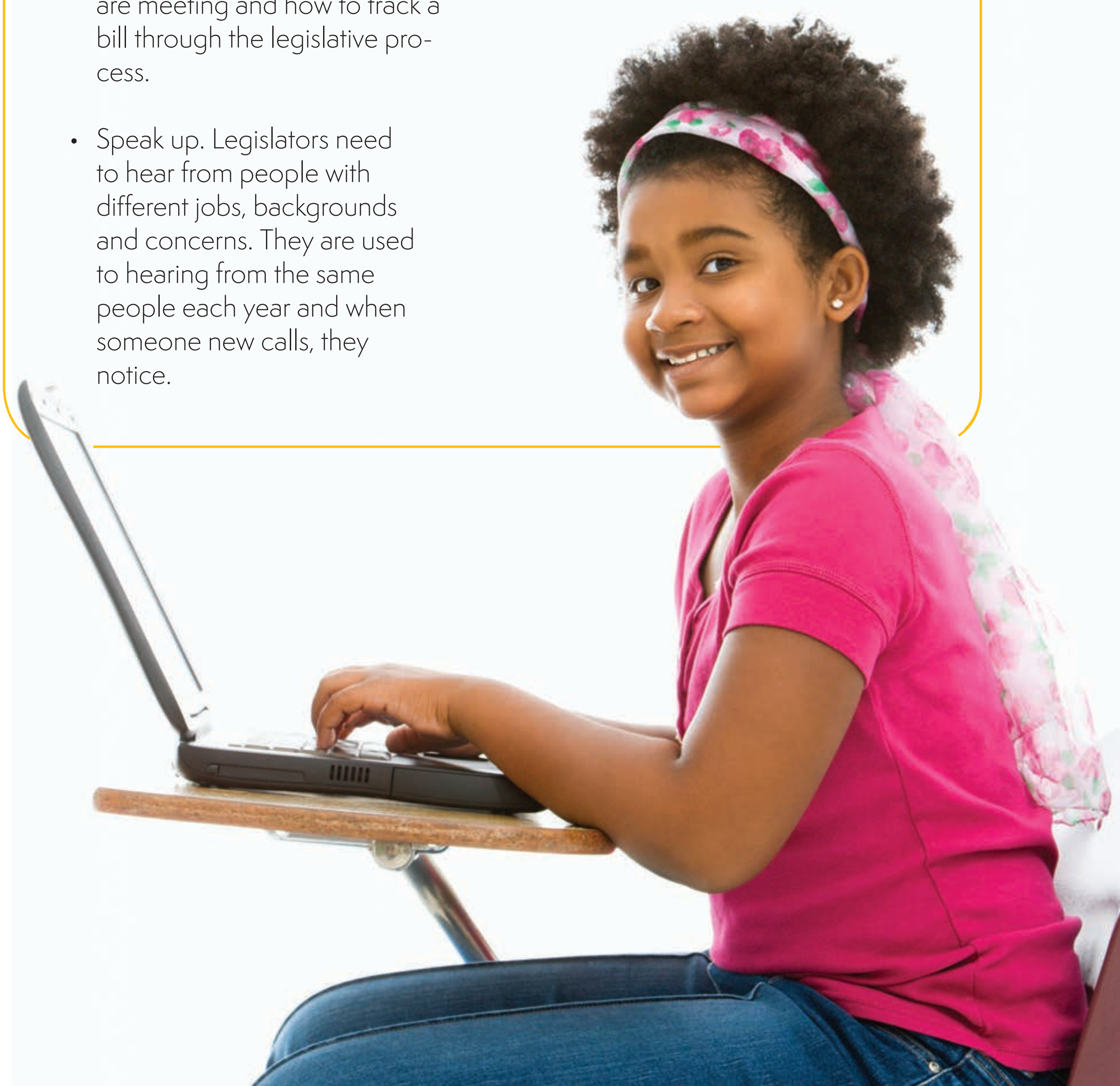
There are many things that advocates can do to help enact sound tax and budget policies:

- Know your legislators – and make sure they know you. Sign up for their email updates. Some have blogs or communicate with constituents through sites like Facebook and Twitter. Add their numbers to your speed dial so you're ready to call when action is needed.

- Explore the General Assembly's website. Learn when committees are meeting and how to track a bill through the legislative process.

- Speak up. Legislators need to hear from people with different jobs, backgrounds and concerns. They are used to hearing from the same people each year and when someone new calls, they notice.

- Never underestimate the power of a letter. Legislators often view a single letter as the equivalent of 10 calls from their constituents on an issue. Whenever possible, sending hand-written notes in your own words (rather than e-mailing form letters copied from lobbying groups) carry even more weight. If you are writing about a specific piece of legislation, be sure to specify the bill number (example: House Bill 1002) and clearly state whether you think they should vote for or against the bill.



- Expand your circle of influence. Talk to your friends and neighbors. They just might pass your message along. Tell them about your advocacy, and how they can get involved, on your Facebook wall.

- Use the media. Letters to the editor are a popular section of the newspaper.

- Be prepared. You never know when a window of opportunity will open, so it never hurts to be prepared. Arm yourself with reliable research and data to support your positions. For example, you can find county-level data on a range of social issues in the Kids Count Data Center on AACF's website: www.aradvocates.org

- Join a coalition. Thousands of bills are filed every session, which can be overwhelming. While some advocacy organizations have staff that can follow the legislative process, the average Arkansan doesn't have the time or resources to follow everything. That's why it's important to join a coalition of people with similar interests and goals.

- Don't forget about electoral advocacy. Because the constitution limits legislators to three terms in office, there is constant turnover in the legislature and a continual need to elect good public servants and educate new members on issues you care about.

- You can't always get what you want…but with persistence, you might be able to get it in the future. Politics is the art of compromise. Be prepared to make trade-offs, build relationships, and keep working for a victory over the long term.

## Tips for speaking with legislators

- *Always be respectful and brief – whether at a committee hearing or the grocery store.*
- *Introduce yourself and your district.*
- *Start on a positive note by finding common ground. For example, if your legislator recently voted to support a children's issue, say thank you.*
- *Clearly state your position on the issue or bill. This is key if your meeting is cut short.*
- *Use personal anecdotes when possible. It will make "real world" sense to your legislator.*
- *If you don't understand something your legislator says, ask him/her for an explanation.*
- *Have your legislator clarify his/her position on the issue.*
- *If you don't know the answer to a question, say so, but offer to find an answer A.S.A.P. Then do it!*
- *Thank your legislator for his/her time and consideration as you leave.*
- *Follow up visits with a phone call, email, or letter.*
- *Always remember not to "burn your bridges" with a legislator over an issue. You may need support on another issue in the future.*

## Conclusion

Arkansans have a lot to be proud of – our breathtaking landscapes, our thriving arts and tourism industries, our commitment to improving public education for all, the list goes on and on. At the same time, Arkansas must invest more in its people and infrastructure in order for us all to thrive in the 21st century.

While many find it fashionable to claim that income tax cuts – and other tax cuts that lead to major reductions in public investments - lead to rapid economic growth, the facts continue to contradict that claim. Time and again we see industry leaders cite educated workforces and investments in infrastructure as driving corporate decisions on where to locate businesses. Additionally we know that issues like availability of quality health care, good public schools, and low crime factor into decision making. A stable, fair tax code is just one of many factors involved in corporate expansion and investment.

Recent studies have also found that tax increases do not drive away investments. A 2011 report from the Center on Budget & Policy Priorities shows that less than two percent (two percent) of all Americans moved from one state to another between 2001 and 2010. And factors that contribute to these moves rarely have anything to do with taxes. Families generally undertake major, expensive moves out of state to follow a job, go to school, or find cheaper housing.[J]

Far too many of our neighbors live in poverty and lack the skills necessary to move up in the workforce and adequately support their families. By learning more about our tax and budget system, you have taken the first step in helping move families in Arkansas forward.

# Resources

## Advocacy organizations and coalitions

### Arkansas Advocates for Children and Families (AACF)

AACF's website includes a wealth of resources on tax and budget and other policy issues, as well as links to our partners' work on these issues and ways you can get involved. http://www.aradvocates.org. Here you can find out about events and subscribe to our email updates on tax and budget issues.

### Arkansas Kids Count Coalition

AACF also staffs the Arkansas Kids Count Coalition, which is part of the Annie E. Casey Foundation's national network of child advocates. The Kids Count Coalition holds Policy Cafes and advocacy trainings throughout the state as well as Kids Count Day at the Capitol and pre- and post-legislative conferences each session. www.aradvocates.org/join-kids-count-coalition/

### Citizens First Congress (CFC) and Arkansas Public Policy Panel (APPP)

The Arkansas Citizens First Congress is a non-partisan coalition of more than 40 organizations who advocate on a range of fiscal and social policy issues in the state. Led by the Arkansas Public Policy Panel, coalition members lobby together for progressive tax and budget policies for all Arkansans. http://www.citizensfirst.org

## State government

### Arkansas General Assembly

The General Assembly's website includes information on all House and Senate members, committee meetings and calendars, research publications, and a searchable database of all pending bills and enacted legislation. http://www.arkleg.state.ar.us

For a very detailed, step-by-step explanation of the legislative process, see the latest Senate Parliamentary Manual: www.arkansas.gov/senate/pdf/ParlimentaryManualSenate.pdf

### Department of Finance and Administration (DFA)

DFA's Office of Budget prepares the state's budget and provides technical and fiscal expertise to various branches and agencies of government: www.dfa.arkansas.gov/offices/budget/Pages/default.aspx

DFA's Office of Economic Analysis and Tax Research staff the House and Senate Tax Committees and the Economic and Tax Policy Committee, prepares the state's monthly revenue report and economic forecasts, and writes revenue impact statements for all bills introduced by the legislature. www.dfa.arkansas.gov/offices/directorsOffice/Pages/default.aspx

### Bureau of Legislative Research (BLR)

BLR staffs most other legislative committees, drafts bills for legislators to introduce and publishes the "Arkansas Legislative Tax Handbook" before each session, which includes a summary and history of all tax changes in the state. BLR also compiles its own revenue estimates each year, which usually match those of DFA, but not always. www.arkleg.state.ar/bureau

## *Endnotes — General Text*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## *Endnotes — Glossary and Sidebars*


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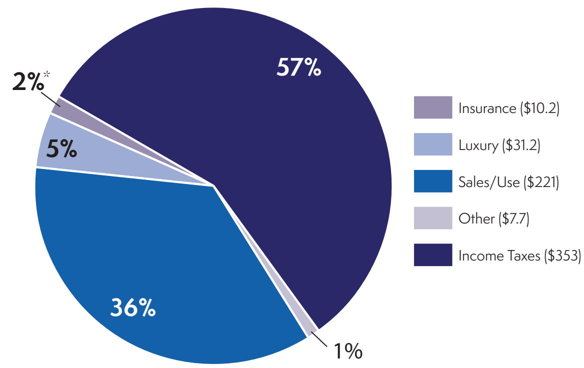
# Appendix

## STATE OF ARKANSAS, GENERAL REVENUE FORECAST, 2014

ARKANSAS GROSS GENERAL REVENUE
Estimated for fiscal year 2014, in millions

**$6,228.4 million**




*Source: "State of Arkansas Fiscal Year 2014 Estimated Gross General Revenue" Arkansas Department of Finance and Administration*

**$1,303.5 million**

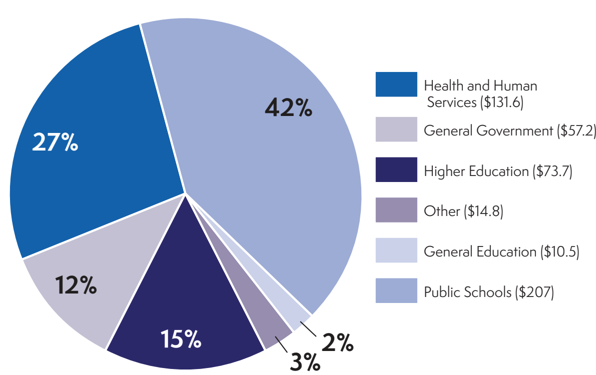
**LESS:**
Central Services/constitutional Officers $205.5 million
Educational Adequacy – Taxes on Services $25.8 million
College Savings Bonds/Debt Service $24 million
Economic Development Incentive $23.4 million
Educational Excellence $291.7 million
City/County Tourist $2.8 million
Desegregation $69.8 million
Refunds $603 million
Water/Sewer $14.8 million
Claims $10 million

=

**AFTER:**
Rainy Day Set Aside per Section 4(a) of Act 1517 of 2013 $18.9 million
Surplus to Revenue Allotment Reserve Fund $13.8 million

*GENERAL REVENUE AVAILABLE FOR DISTRIBUTION*
*Fiscal year 2014, in billions*

**$4,924.9 million**




*Source: "Total General Revenue Available for Distribution Fiscal Year 2014" Department of Finance and Administration*

**Percentages rounded to nearest whole number*

ARKANSAS ADVOCATES FOR CHILDREN & FAMILIES

*Report authored by staff at Arkansas Advocates for Children and Families*
**October 2013**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