Arkansas's Upside-Down Tax System

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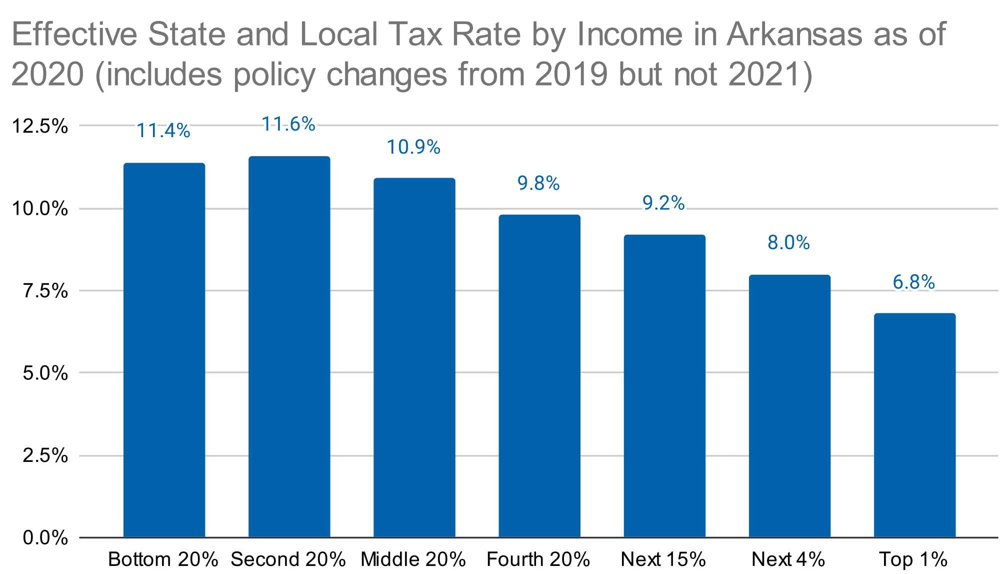
Introduction

We all want to live in a great state where everyone can thrive and achieve economic prosperity. But Arkansas consistently ranks near the bottom of the states in terms of health, education, and economic security. Investing in the foundations of our communities by ensuring we have great public schools, safely maintained roads and bridges, and healthy families and communities would grow the economy and make sure every Arkansan could prosper.

Revenues from state and local taxes can be used to build this stronger, more equitable economy. But to make sustainable, forward-thinking investments that benefit us all will require wealthy households and profitable corporations to pay their fair share. Successive rounds of tax cuts over the years have led to underfunding or flat-funding things that benefit all Arkansans, like afterschool and summer programs, high quality Pre-K, infrastructure needs, and more.

By law, Arkansas requires the Governor to submit a balanced budget. That means every cent of a tax cut needs to be paid for, either through reduced spending or through increased tax collections in other areas. Every penny of revenue lost has to be made up for by cuts to the investments that really spur economic growth, like good schools and well-maintained roads and bridges. Alternatively, taxes can be raised in other areas to make up for the lost revenue.

The tax system in Arkansas asks for more from those with less, with lower-income families paying more as a share of their income than affluent families do, according to an analysis by the non-partisan Institute of Taxation and Economic Policy (ITEP).



Source: ITEP Analysis

2015 Income	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	$0 $18,599	$18,600 – $30,599	$30,600 – $48,799	$48,800 – $82,999	$83,000 – $173,799	$173,800 – $422,399	$422,400 – Or More
Average Income in Group	$11,200	$25,500	$46,000	$62,700	$112,900	$247,000	$1,129,400

Source: ITEP Analysis

Sales Tax

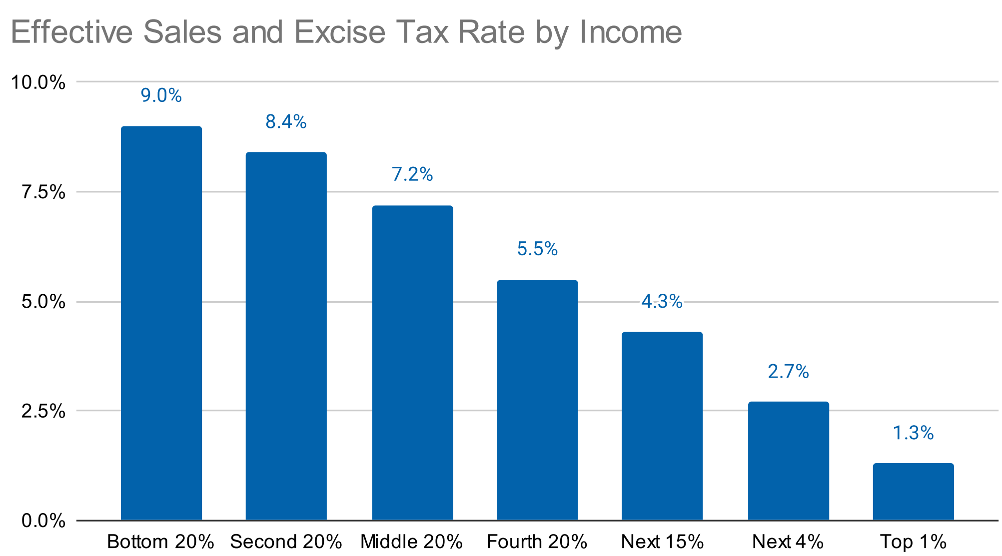
There are several reasons lower-income Arkansans are paying more than their fair share of taxes. One of the most important is our heavy reliance on consumption taxes, like the general sales tax, which fall most heavily on poor and working Arkansans. Sales taxes are imposed on the purchase of many – but not all – goods and services. In Arkansas, sales taxes are levied on the purchase of nearly all physical goods, though some goods like food are taxed at a lower rate on the state level.

In addition to the general sales tax, Arkansas has "excise" taxes on many goods, which are taxes that fall on specific goods like alcohol, gas, and tobacco.

All things considered, wealthier Arkansans pay much less as a share of their income in sales and excise taxes.

In fact, at 9.51 percent, Arkansas has the 3rd-highest combined state and local sales tax rate of any state in the country according to the conservative-leaning Tax Foundation.

Amendment 19 of the Arkansas constitution sharply limits the ability of the legislature to raise taxes by requiring a ¾ majority. However, this only applies to taxes that were in existence when the amendment was ratified in 1934. That means the general sales tax, which was not in existence at the time, only requires a simple majority to raise.



Source: ITEP Analysis

Income Tax

The income tax, on the other hand, was in existence before 1934 and therefore requires a ¾ majority vote to increase. The personal income tax is one of the best ways to address a regressive tax system by asking more of families with higher incomes, but only if it's properly structured.

In other states with an income tax, and on the federal level, as a taxpayer's income increases, the rate at which that income is taxed increases. Different tax rates are levied on income in different ranges; on the federal level, for example, a taxpayer making $150,000 and a taxpayer making $20,000 both paid a rate of 10 percent on the first $9,875 they earned in 2020 (assuming both had single filing status).

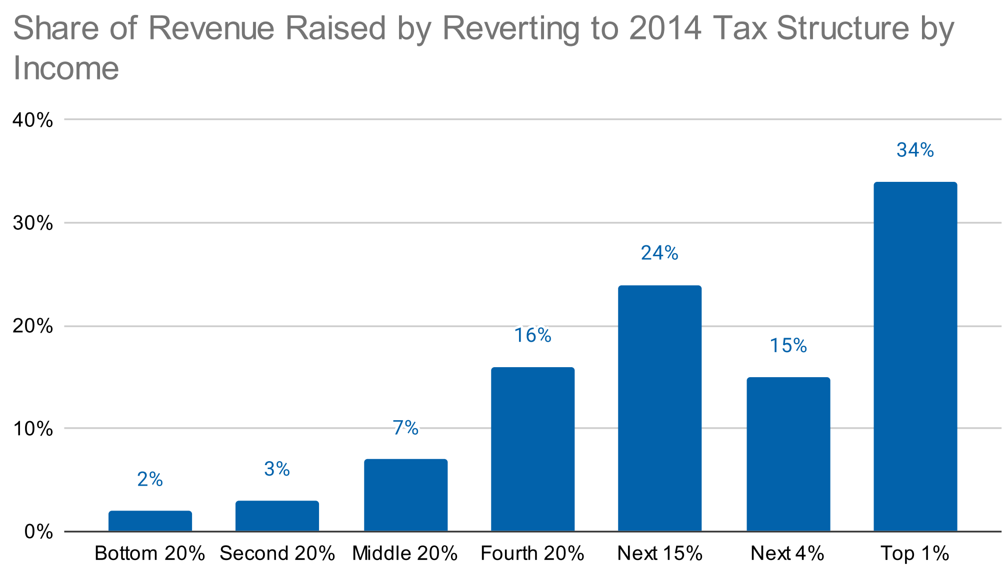
That's not true in Arkansas. Arkansas has a unique personal income tax in that there are three entirely separate income tax tables, a low-, middle- and high-income tax table, each with different brackets.

Low Income Table		Middle Income Table		High Income Table	
Income	Tax Rate	Income	Tax Rate	Income	Tax Rate
$0 to $4,699	0.00%	$0 to $4,699	0.75%	$0 to $4,200	2.00%
$4,700 to $9,199	2.00%	$4,700 to $9,199	2.50%	$4,201 to $8,300	4.00%
$9,200 to $13,899	3.00%	$9,200 to $13,899	3.50%	$8,301 or more	5.90%
$13,900 to $22,899	3.40%	$13,900 to $22,899	4.50%		
		$22,900 to $38,499	5.00%		
		$38,500 to $82,000	5.9%		

Source: https://www.arkansasonline.com/news/2021/jun/22/arkansas-individual-income-tax-rates-explained/

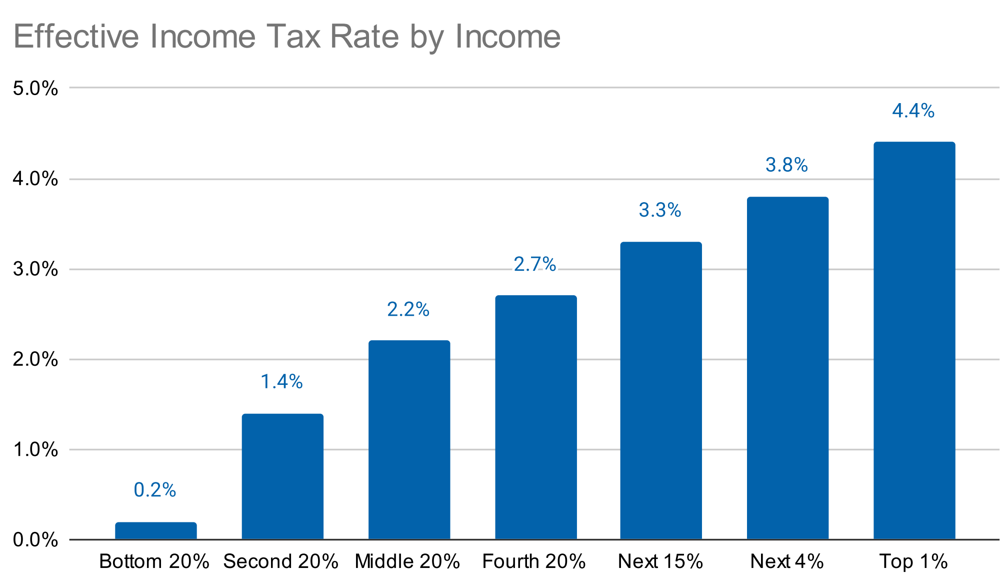
This structure is the result of 2015 legislation, though the top tax rate at that time was 6.9 percent, which is one reason the income tax falls short of correcting the impact of regressive sales taxes on our state tax code. Since then, subsequent tax cuts have dropped the top tax rate down to 5.9 percent, which has primarily benefited the highest income Arkansans.

According to an analysis by ITEP, if we reverted to the personal income tax table and rates we had in 2014 (prior to the changes in 2015), we could raise nearly $400 million in annual revenue and more than one-third of that would come from the one percent of Arkansans making more than $500,000 in annual income. The 60 percent of Arkansans that make less than $60,000 would put in less than half as much combined.



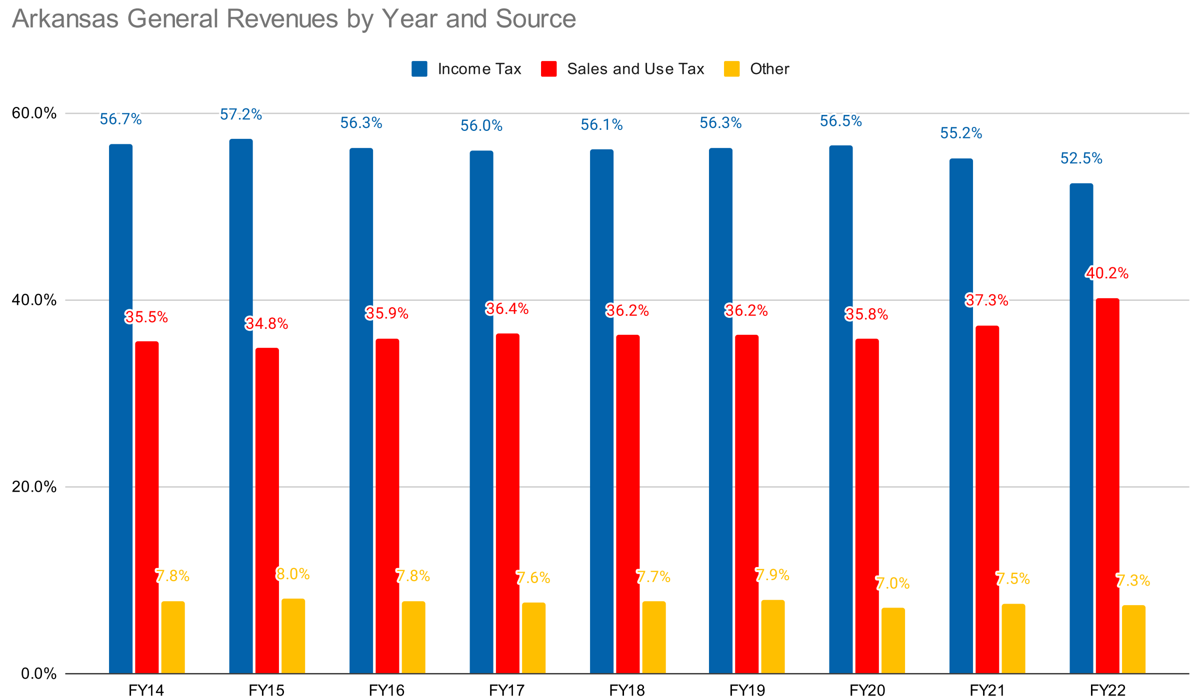
Source: ITEP Analysis

So, the personal income tax does help improve our tax system by asking for more from those who have higher income. But cuts to the top tax rate mainly benefit wealthier Arkansans and make the personal income tax less effective at raising revenue and improving the equity in our tax system.



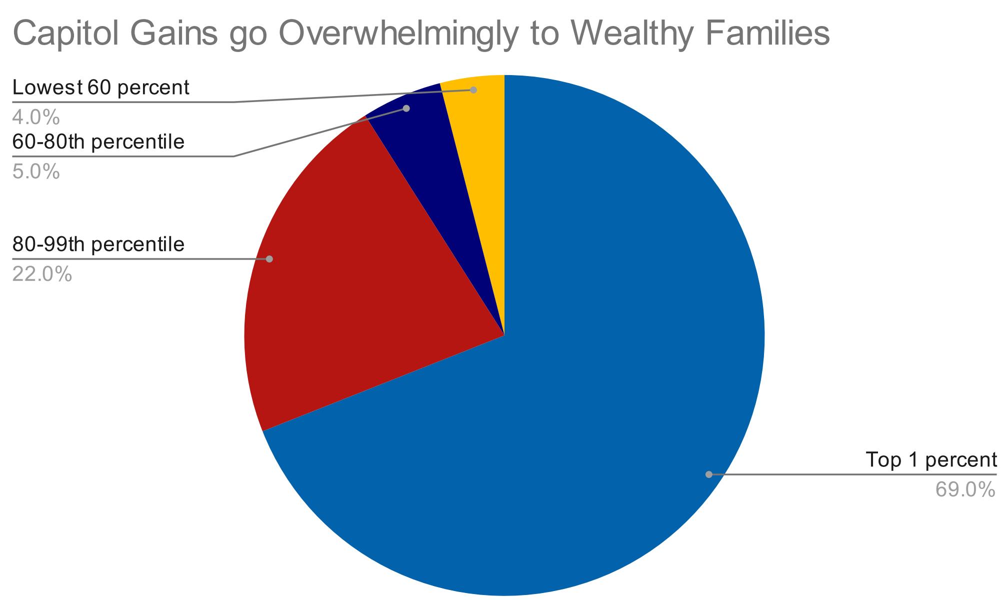
Source: ITEP Analysis

This can be seen clearly by looking at Arkansas's general revenues over time. We raise the majority of our state revenue through income and sales taxes, but the share of the budget funded by income taxes has fallen from 56.7 percent of our own-source revenue in Fiscal Year 2014 to only 52.5 in Fiscal Year 2022. During the same time, sales taxes grew from 35.5 percent to over 40 percent.



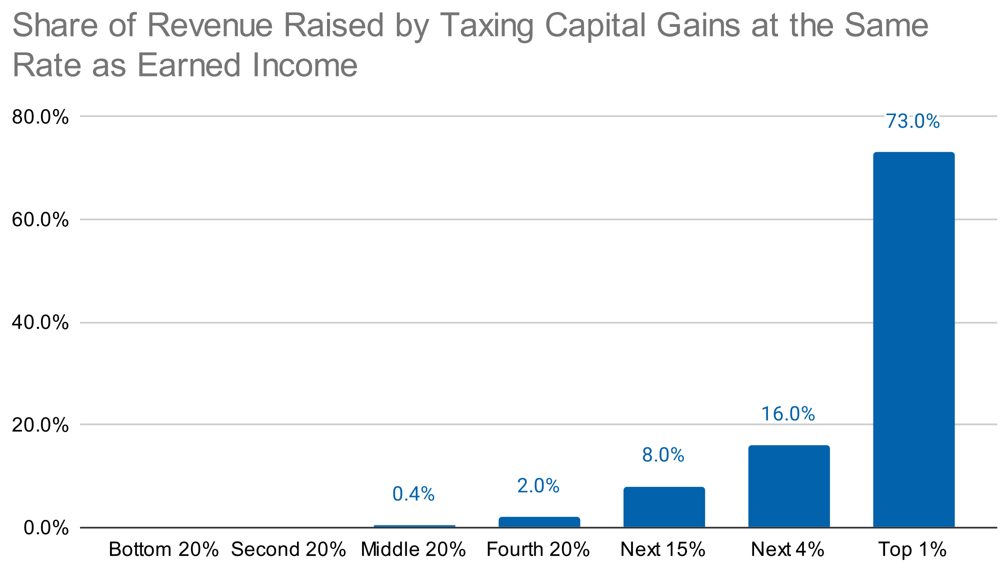
Source: analysis of Arkansas Department of Finance and Administration, General Revenue Flowchart FY14-FY22, https://www.dfa.arkansas.gov/budget/general-revenue/

Another issue is that not all income is treated equally. For example, money made through investing is taxed at a lower rate than money made through working because Arkansas exempts half of all "capital gains" income. And any capital gains income over $10 million is totally exempt from income taxes. The vast majority of capital gains income goes to wealthy families.



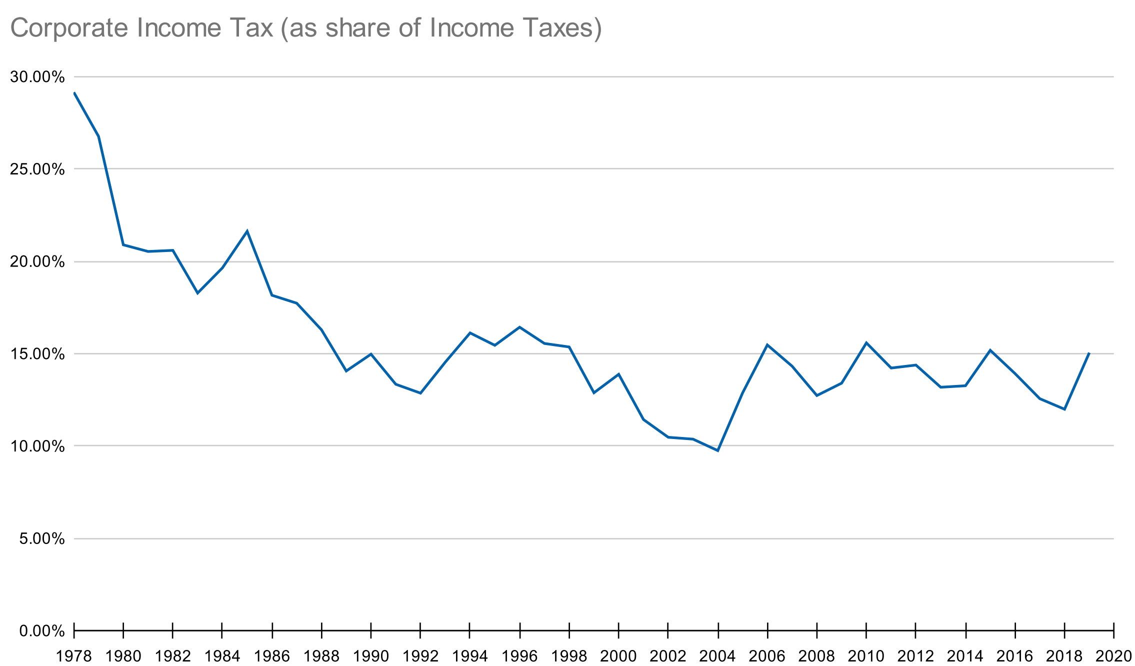
Source: Center on Budget and Policy Priorities | CBPP.org

If Arkansas taxed capital gains at the same rate as earned income, we would raise more than $191 million in annual revenue, and 89 percent of that would come from the wealthiest 5 percent of Arkansans.



Source: ITEP Analysis

Another source of revenue that can help address the inequity in our tax system are corporate income taxes, which primarily fall on wealthy shareholders. But corporate income tax collections have been falling as a revenue source for years.



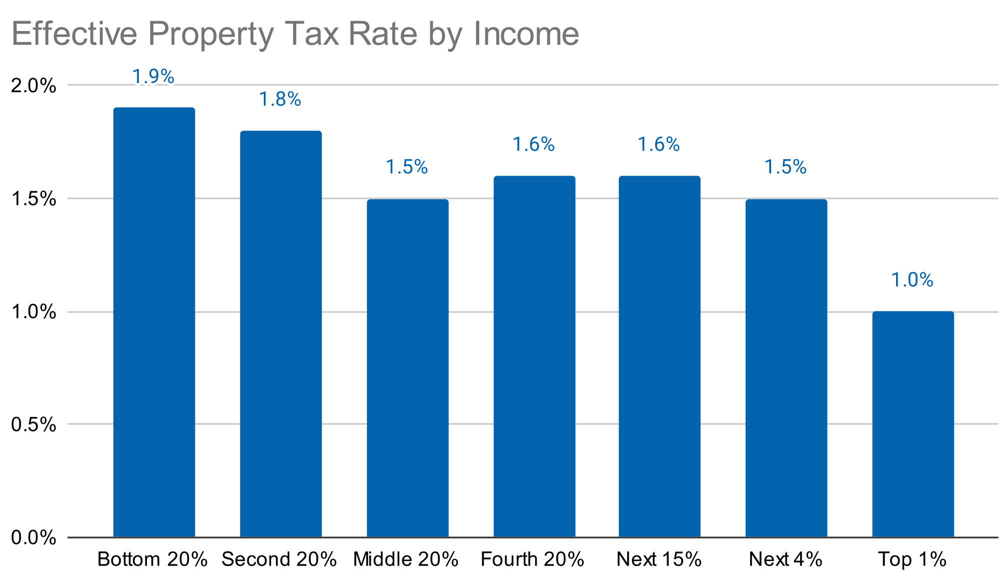
Source: US Census Bureau Annual Survey of State and Local Government Finances, 1977-2019 (compiled by the Urban Institute via State and Local Finance Data: Exploring the Census of Governments; accessed 03-Sep-2021 09:45), https://state-local-finance-data.taxpolicycenter.org

Some of this is because of the decision policymakers have made to lower corporate tax rates over the years, but corporations are also good at finding ways to minimize their taxable income through sophisticated tax avoidance strategies. Arkansas could do more to prevent that and shore up revenue from corporate income taxes by enacting a combined reporting requirement.

Most large, multistate corporations are composed of a “parent” corporation and some number of “subsidiary” corporations owned by the parent. Combined reporting essentially treats a parent and its subsidiaries as one entity for the purposes of state income taxes. That nullifies a variety of tax avoidance strategies multistate corporations have devised, as outlined in more detail in the Arkansas Advocates for Children and Families brief, Corporate Income Tax Cuts In Arkansas: The Need For Combined Reporting.

Property Tax

Arkansas doesn’t levy much in property taxes at the state level compared to most states. That’s partially because so much of the property tax incidence in Arkansas falls at the local level, particularly to finance schools and school districts. But even considering that, Arkansas is a low property tax state.

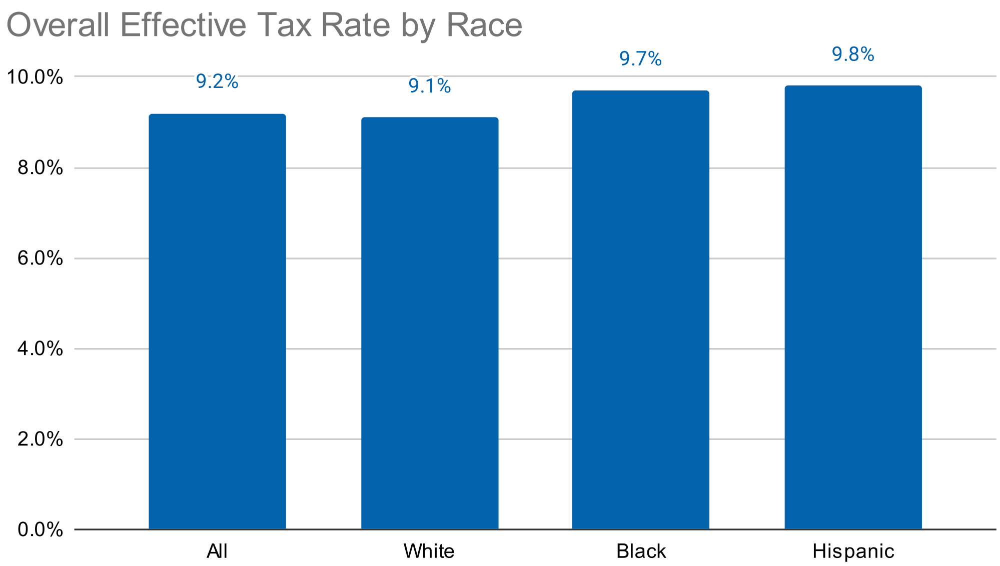


Source: ITEP Analysis

To make up for this, policymakers are incentivized to find other means to fund public services – like sales taxes. That’s why, even as we cut income taxes, we now have the third-highest sales tax rate in the country, up from ninth highest a decade ago in 2011.

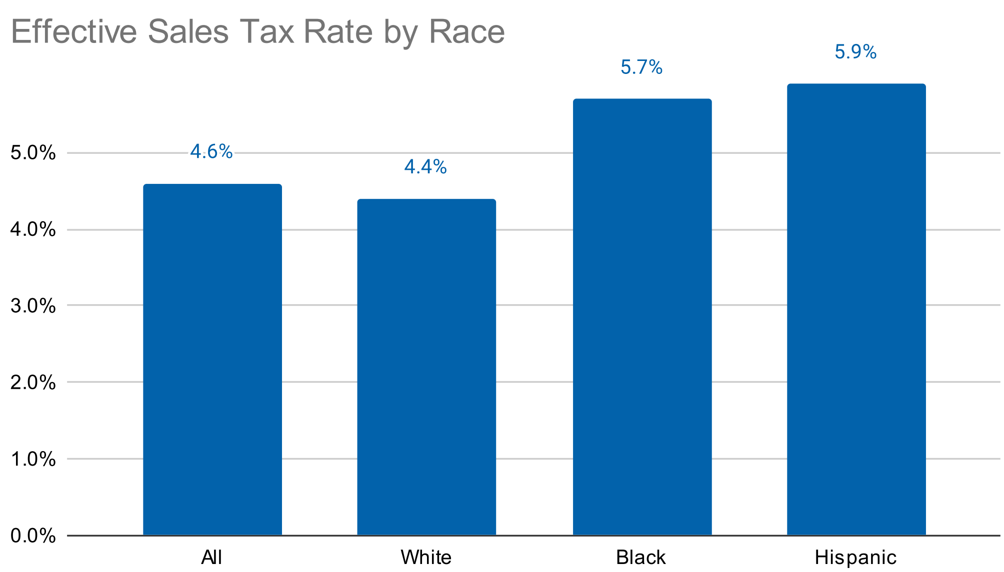
Racial Equity

Set against a backdrop of historical and ongoing injustices that have locked Black, Indigenous and Other People of Color (BIPOC) out of economic opportunities, from redlining and inequitable school funding, to discrimination in the workforce and criminal justice systems, Arkansas's tax code further deepens racial inequality. According to an ITEP analysis, Black and Hispanic Arkansans pay more as a share of their income overall in state and local taxes.



Source: ITEP Analysis

Heavy reliance on sales and excise taxes is the primary culprit leading to low- and middle-income families paying a larger share of their incomes in state and local taxes than the rich, which has a disproportionately negative effect on Black and Hispanic Arkansans.



Source: ITEP Analysis

Building a Tax System that Works for All Arkansans

State revenue can be used to build a stronger, more equitable economy in Arkansas. But only if, instead of cutting income taxes that take money away from the services Arkansans all need to thrive, we look for ways to strengthen our income tax collection by requiring corporations and the wealthy to pay their fair share. Some sensible ways to raise revenue to help us in invest in shared prosperity are:

- Implement a combined reporting requirement for corporations
- Raise the top personal income tax rate and create a new top "millionaires" tax bracket
- Implement a "mansion tax" on expensive homes

These strategies would help give us the revenue we need to ensure that all families in Arkansas can live in a safe, secure home; afford to go to the doctor; and get a quality education for their children.

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