

PAYCHECK \$ and POLITICS

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The Impact of 2003-04 Tax Changes on Arkansas Families

By Richard Huddleston

The last two years have been historic ones for the Arkansas tax and budget system. The Arkansas General Assembly enacted nearly \$500 million in tax increases to plug a Medicaid budget shortfall for vulnerable populations and to reform K-12 education in response to an Arkansas Supreme Court mandate in the Lake View school-funding case.

Among the major state tax changes Arkansas adopted during the 2003 and 2004 legislative sessions:

- The working taxpayer credit (a personal income tax credit) was repealed for everyone except for families who file Arkansas income taxes using the low-income tax tables.
- A 3 percent state income surcharge was enacted for individuals and corporations.
- The state sales tax was increased by 7/8s of a percent to 6 percent and the sales tax base was expanded to include a variety of small business services, such as wrecker and towing services, dry cleaning, etc.
- The cigarette tax was increased by \$12.50 per 1000 cigarettes (about 25 cents per pack) and the excise tax on cigars and other tobacco products was increased by seven percent.
- The minimum corporate franchise tax was increased from \$50 to \$150 or \$100 to \$300 for those corporations and limited liability corporations paying the minimum tax.

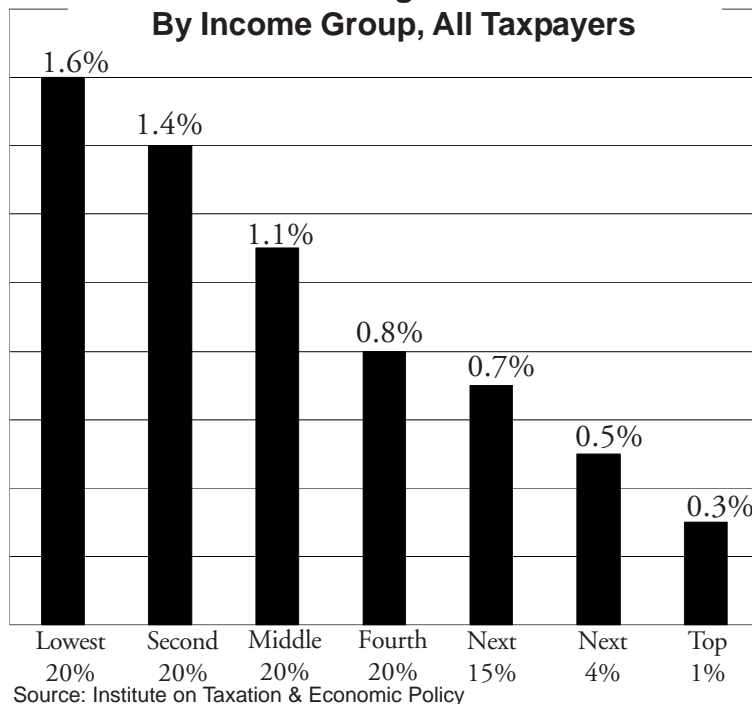
While these changes raised much needed revenue for critical areas such as health care for low-income populations, quality pre-school for 3 and 4 year olds, and K-12 education reform, they also had major impacts on the overall fairness of the Arkansas tax system. Among the impacts:

Low-income and middle income working families have borne the burden of recent tax changes.

Low-income families took the biggest hits from changes Arkansas enacted in 2003 and 2004. The state and local tax burden for the poorest 20 percent of families, those with incomes less than \$13,000, increased by 1.6 percent of their income (\$119). Middle-income families, those with incomes between \$21,000 and \$35,000, saw their tax burden increase by 1.1 percent (\$302).

In contrast, the state and local tax burden for the top 1 percent of families increased by only 0.3 percent of their income (\$1,896). As a percent of their income, the impact of recent tax changes was *five times greater* for the state's poorest taxpayers than for Arkansas' richest!

**Changes in AR Taxes as Shares of Income
After 2003/2004 Legislative Sessions
By Income Group, All Taxpayers**



Sales tax increases hurt low- and middle-income families the most. The major reason for the big increase in low- and middle-income tax burdens was the large sales tax increase. The state sales tax rate was raised by 7/8s of a percent and the sales tax base was expanded to include many small business services. The state sales tax rate is now 6 percent plus any local sales taxes, which are as high as 3 or 4 cents in some counties. Arkansas now has one of the highest sales tax burdens in the country.

Recent sales tax changes accounted for all of the 1.6 percent increase in state and local taxes for low-income families and most of the 1.1 percent increase for middle-income families. Sales taxes hurt low- and middle-income families the most because a larger share of family incomes is spent for basic living needs, such as bread and milk, clothing, soap and toilet paper, etc. In contrast, high-income taxpayers have more disposable income that is not spent on items that are subject to sales taxes, such as money put in a savings account or some other financial investment.

Low- and middle-income families have the highest state and local tax burden. Low-income families pay nearly twice as much (as a percent of their income) than do the state's highest income families. Low-income families pay about 12 and ½ cents in state and local taxes on every \$1.00 they earn, middle-income families pay nearly 12 cents, while the top 1 percent of families pay just 6 cents on every dollar. As a percent of every dollar they earn, low-income working families now pay more than *twice as much* as Arkansas' most well-to-do families.

What is a fair tax system? Historically, **progressive** tax systems have been regarded as the fairest type of tax system. Under a progressive tax system, the percent of income you pay in state and local taxes rises as your income rises. A progressive tax system is based on the belief that those with a greater ability to pay can and should pay a larger share of their income in taxes and bear more of the burden. Regressive systems are considered the least fair type of tax system. Under a **regressive** system, low-income families pay a greater share of their income in taxes than do upper-income taxpayers. Arkansas' current system requires that low-income families pay more than 12 cents of every dollar they earn for state and local taxes, compared to just 6 cents of every dollar for the top 1 percent of taxpayers. By any standard, this is a very regressive tax system.

Sales tax increases come at a time when working families are struggling to meet basic needs. According to recent data from the U.S. Census Bureau, many Arkansas families are either in poverty or close to poverty. Nearly 24 percent of all children live in poverty (27 percent for children under age five). Many more children live on the edge of poverty. According to a study by Arkansas Advocates for Children & Families, it really takes an income nearly 200 percent of the federal poverty line to meet all basic needs, such as food, clothing, utilities, etc. Recent Census data found that nearly 50 percent of all Arkansas children live in families earning below 200 percent of the poverty line, placing them at risk of not having basic needs met.

Arkansas State and Local Taxes after 2003-04 Legislative Changes As Shares of Family Income for Non-Elderly Taxpayers

Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income Range	Less Than 12,000	\$12,000 - \$20,000	\$20,000- \$33,000	\$33,000- \$55,000	\$55,000- \$100,000	\$100,000- \$242,000	\$242,000 or more
Average Income in Group	\$7,000	\$16,200	\$26,800	\$43,400	\$71,700	\$137,900	\$498,100
Sales and Excise Taxes	10.2%	9.1%	8.0%	6.1%	4.8%	3.1%	1.6%
Property Taxes	1.9%	1.6%	1.2%	1.5%	1.4%	1.5%	1.1%
Income Taxes	0.2%	1.6%	2.6%	3.0%	4.0%	4.7%	5.5%
TOTAL TAXES	12.4%	12.3%	11.8%	10.6%	10.2%	9.3%	8.2%
Federal Deduction Offset	-----	- 0.1%	- 0.0%	- 0.2%	- 0.8%	- 1.5%	- 2.0%
Burden After Offset	12.4%	12.2%	11.8%	10.3%	9.5%	7.9%	6.1%

Note: Tax burden includes the impact of Arkansas tax changes enacted during 2003-04

Source: Institute on Taxation and Economic Policy, August 2004

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