State and Local Revenue-Raising to Strengthen Pension Funding: Issues and Options

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9/12/2019

Introduction to ITEP

The Institute on Taxation and Economic Policy (ITEP) is a non-profit, non-partisan research organization that works on federal, state, and local tax policy issues. ITEP's mission is to ensure that elected officials, the media, and the general public have access to accurate, timely, and straightforward information that allows them to understand the effects of current and proposed tax policies.

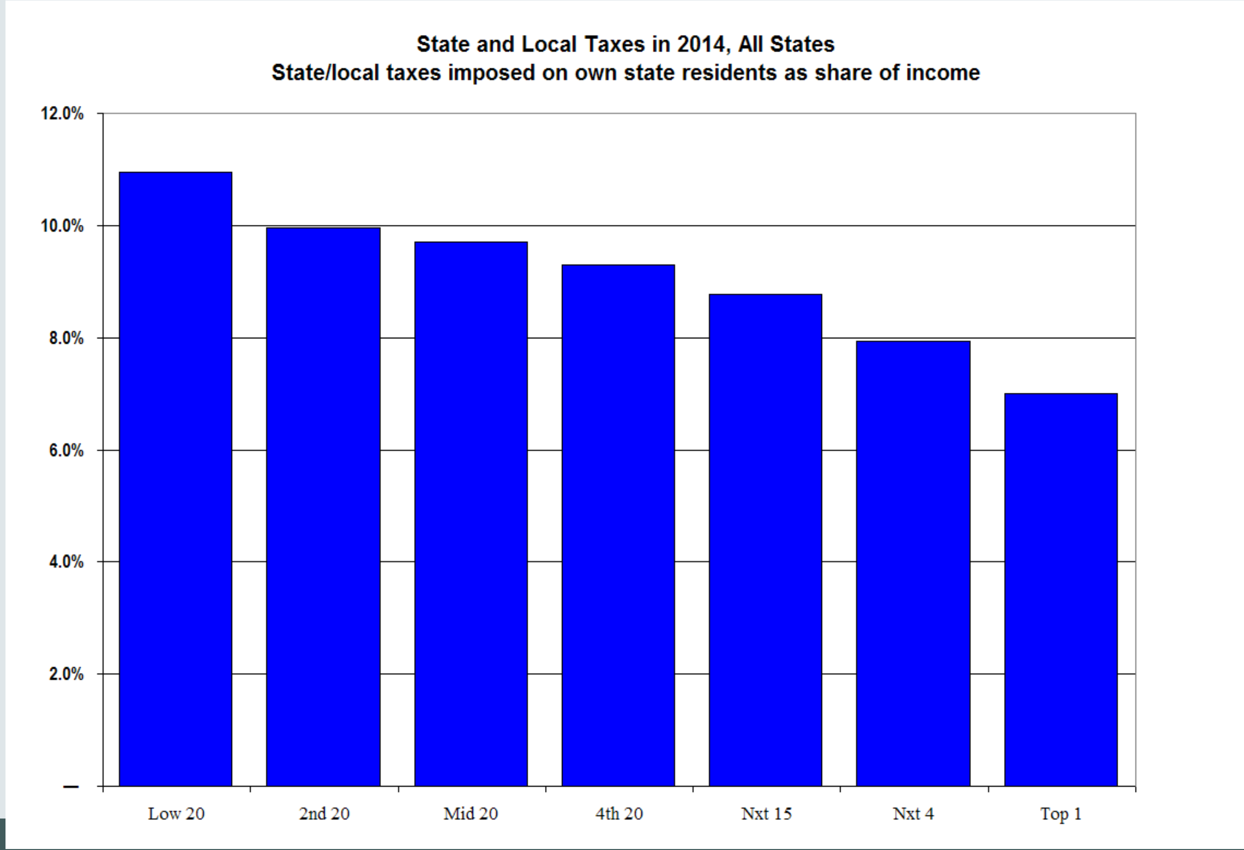
What's Driving Pension Funding Shortfalls?

- Unaffordable tax cuts (NJ, mid-90s)
- Major cuts in pre-funding of pension liabilities (also NJ)
- Expanding pension benefits without funding them (IL, early 90s)
- "Pension reforms" that depend on the political will of future generations (also IL)
- Volatile earnings stream from pension plan assets.

Evaluating Revenue-Raising Strategies for Pension Funding

- Short-term adequacy: identify strategies that contribute enough in the short-term.
- Long-term sustainability: tap revenue sources that will grow over the long haul.
- Fairness, part 1: don't enact solutions that hit low-income families hardest.
- Fairness, part 2: enact reforms that treat all forms of income, wealth and consumption the same.
- Fairness, part 3: think about intergenerational equity issues.

Nationwide, state and local taxes are regressive.



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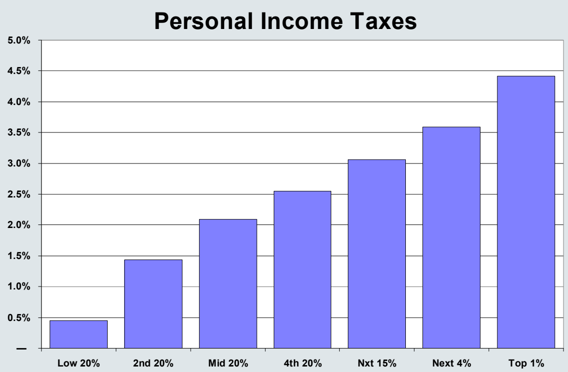
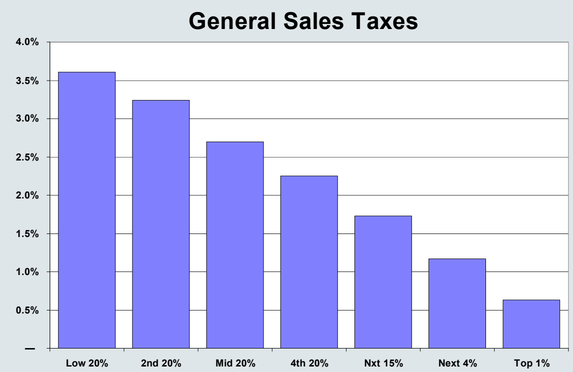
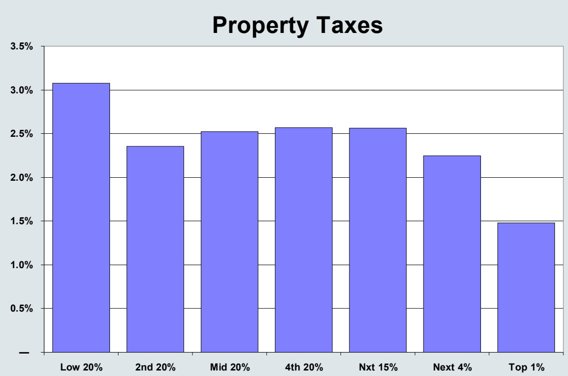
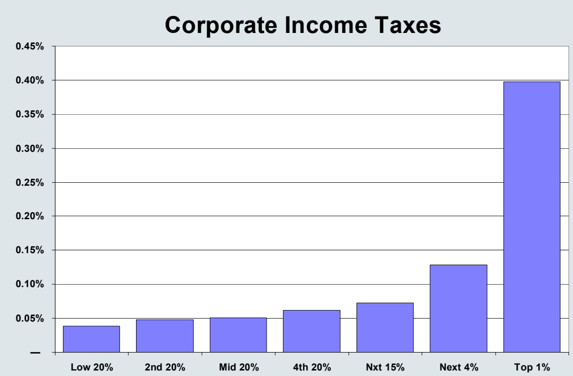
This regressive pattern results from the interaction between personal income taxes, sales and excise taxes, property taxes, and corporate income taxes.









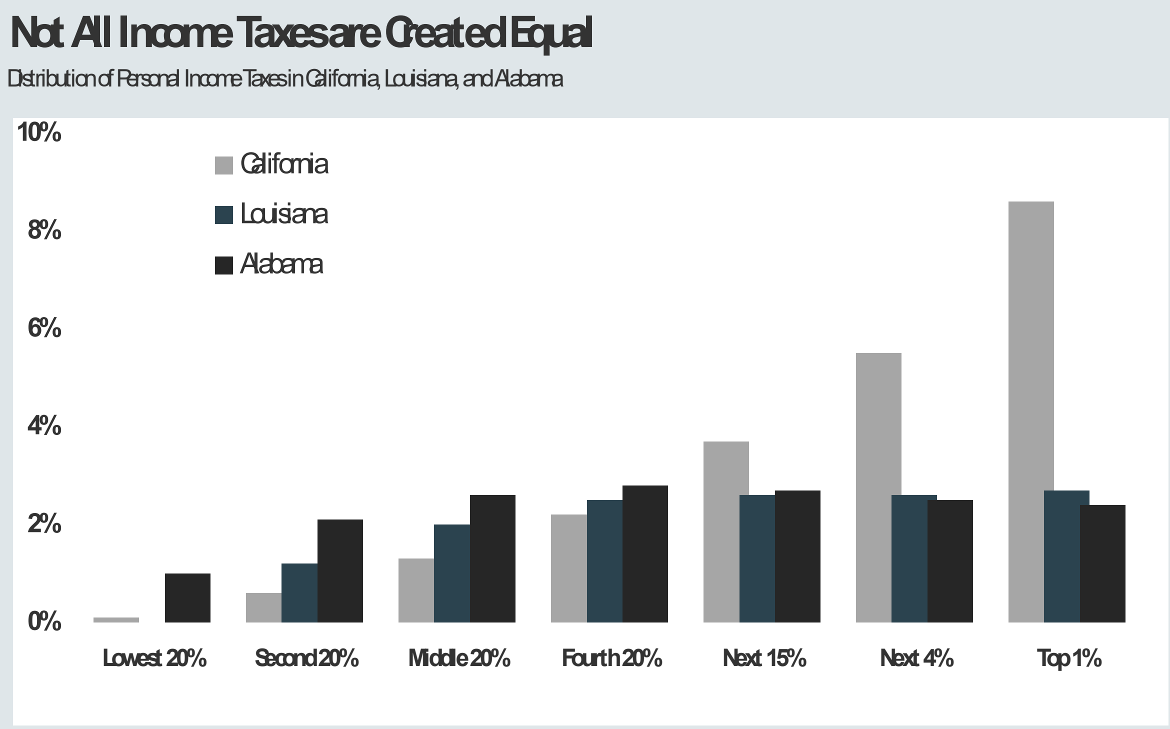
The State of State Corporate Income Taxes: 3 Percent and Dropping

- 2017 ITEP study assesses effective state corporate income tax rates nationwide, Fortune 500 firms only
- Weighted-avg statutory corporate rate was 6.2%; between 2008 and 2015, avg effective rate was 2.9%.
- This suggests profitable companies are avoiding tax on over half of their profits at the state level.
- Eight-year revenue loss from this gap: $126 billion

State Corporate Income Tax Reform Options

- Don’t give up. Repeal has not worked well for states taking this path.
- Focus first on base-broadening reforms
- Decouple from harmful federal loopholes, esp. those created by 2017 federal tax cut
- Pare back accelerated depreciation tax breaks
- “Minimum tax” to ensure basic compliance with spirit of tax law.

“Progressive” personal income taxes often aren’t.



Personal Income Tax Reform Options

- PIT is the fairest major tax, and generally the most sustainable as well.
- Best approach: base-broadening. Increase tax rates as a second-best strategy.
- Itemized deductions: targeted to best-off. States and feds show range of options: cap $ value, phase out for best off, convert deduction to tax credits.
- Eliminate capital gains tax breaks & other carveouts.
- “Millionaire tax:” ensure graduated rate structure for top 20% of income distribution.

Personal Income Tax Reform Options

- 1% tax on AGI over $1 million would yield $14 billion nationwide in 2020; $33 billion if taxed over $500,000.
- California: comparable #s are $2.8 billion and $3.8 billion.
- Illinois: $540 million and $800 million.
- New Jersey: $500 million, $700 million.

Consumption Tax Reform Options

- Sales taxes are generally less sustainable, and clearly less fair. Excise taxes are utterly unsustainable.
- But each can be reformed to ease sustainability problems.
- Sales taxes generally tax goods (slow growth) and exempt services (faster growth).
- Internet-based transactions often exempt. *Wayfair* decision opens the door for closing this loophole.
- Converting excise taxes (esp. fuel) to value-based rather than unit-based adds sustainability.

Other Revenue-Raising Options

- Gaming revenue: regressive, likely not sustainable, but can raise needed funds in short term.
- Estate/inheritance tax: important backstop to PIT.
- Statewide property tax
- Transparency tools: clearer accounting of pension shortfalls, tax expenditure reports to ID solutions.
- Federal aid: reverse the effect of SALT deduction caps.

Low-Income Relief Strategies

- Regressive revenue raisers can be mitigated through low-income targeted tax breaks:
- More graduation in income tax rate structure
- Low-income “no tax floor”
- Refundable low-income tax credits (EITC, sales tax credit, “circuit breakers.”