

MEMORANDUM

OKLAHOMA TAX COMMISSION
TAX POLICY AND RESEARCH

DATE: February 16, 2013
SUBJECT: SB 585 - Proposed Committee Substitute
TO: Rick Miller, Director
FROM: Michael C. Kaufmann, Tax Policy Analyst

The Proposed Committee Substitute for SB 585 proposes the following income tax changes:

- Retains the current progressive individual income tax rate structure with the top marginal tax rate at 5.25% for tax year 2012 through tax year 2014. Effective with tax year 2015 and subsequent tax years, the top marginal rate will be reduced to 4.75%.
- Limits the personal exemption (subject to income limits and number of personal exemptions) in tax year 2015.
- Limits itemized deductions to 80% of their value for taxpayers with federal adjusted gross income over \$100,000 (\$200,000 for married filing joint taxpayers).
- Eliminates the transferability of four (4) income tax credits¹, effective for tax year 2014, but provides that the amount of the credit allowed, but not used, may be refunded to the taxpayer at an amount equal to eighty percent (80%) of the amount eligible to be claimed in tax years 2014, 2015 and 2016, with the credits completely eliminated in tax year 2017.
- Eliminates or amends numerous income tax credits, deductions and exemptions, effective for tax year 2015 and all subsequent tax years.²

Estimated Revenue Impact:

For FY 15 there is a projected net decrease of \$43,555,000 in revenue (decrease in income tax collections of \$57,509,000 and increase in insurance premiums tax collections of \$13,954,000). For FY 16 there is a projected net decrease of \$108,373,000 (decrease in income tax collections of \$122,327,000 and increase in insurance premiums tax collections of \$13,954,000).

¹ **Credit for Electricity Generated by Zero-Emission Facilities** (eliminated for tax year 2016 and all subsequent tax years; eliminates the transferability of this credit beginning tax year 2014, but provides the credit may be refundable at an amount equal to 80% of the amount eligible to be claimed in tax years 2014 and 2015); **Tax Credit for Qualified Rehabilitation Expenditures**; **Credit for Eligible Expenditures Incurred by a Contractor in the Construction of Energy Efficient Residential Property**; and **Credit for Eligible Taxpayer's Qualified Railroad Reconstruction or Replacement Expenditures**.

² Credits earned before tax year 2015 that have carryover provisions would still be allowed.

Summary of Legislation:

Section 1 – Amends 27A O.S. § 2-11-303 (**Credit for Investment in Equipment Used for Recycling, Reuse, or Source Reduction of Hazardous Waste**) by eliminating the credit for tax year 2015 and all subsequent tax years.

Section 2 – Amends 36 O.S. § 252.11 which relates to the home office credit for insurance premiums tax.

Section 3 – Amends 68 O.S. § 2355, by reducing the top marginal **individual income tax rate** to 5.25% in 2012 through 2014 and by reducing the top marginal **individual income tax rate** to 4.75% for tax year 2015 and subsequent tax years.

Section 4 –

1. Amends 68 O.S. § 2357(B)(2) (**Child Care / Child Tax Credit**) by eliminating the credit for taxpayers with federal adjusted gross income over \$50,000 for tax year 2015 and all subsequent tax years.

2. Amends 68 O.S. § 2357(C)(3) (**Gas Used in Manufacturing**) by eliminating the credit for tax year 2015 and all subsequent tax years.

Section 5 – Amends 68 O.S. § 2357.4 (**Oklahoma Investment/New Jobs**) by limiting the credit to the new jobs portion only beginning with tax year 2015 and for all subsequent tax years.

Section 6 – Amends 68 O.S. § 2357.6 (**Energy Conservation Assistance Fund Credit**) by eliminating the credit for tax year 2015 and all subsequent tax years.

Section 7 – Amends 68 O.S. § 2357.11 (**Oklahoma Coal Production Credit**) by eliminating the credit for tax year 2015 and all subsequent tax years.

Section 8 – Amends 68 O.S. § 2357.24 (**Deduction for National Historic Property**) by eliminating the deduction for tax year 2015 and all subsequent tax years.

Section 9 – Amends 68 O.S. § 2357.26 (**Employers Child Care Services Credit**) by eliminating the credit for tax year 2015 and all subsequent tax years.

Section 10 – Amends 68 O.S. § 2357.27 (**Child Care Service Provider Credit**) by eliminating the credit for tax year 2015 and all subsequent tax years.

Section 11 – Amends 68 O.S. § 2357.30 (**Small Business Guaranty Fee Credit**) by eliminating the credit for tax year 2015 and all subsequent tax years.

Section 12 – Amends 68 O.S. § 2357.32A (**Credit for Electricity Generated by Zero-Emission Facilities**) by eliminating the credit for tax year 2016 and all subsequent tax years. Also eliminates the transferability of this credit beginning tax year 2014, but provides the credit may be refundable at an amount equal to 80% of the amount eligible to be claimed in tax years 2014 and 2015.

Section 13 – Amends 68 O.S. § 2357.33 (**Hepatitis Immunization Credit**) by eliminating the credit for tax year 2015 and all subsequent tax years.

Section 14 – Amends 68 O.S. § 2357.41 (**Tax Credit for Qualified Rehabilitation Expenditures**) by eliminating the credit for tax year 2017 and all subsequent tax years. Also eliminates the transferability of this credit beginning tax year 2014, but provides the credit may be refundable at an amount equal to 80% of the amount eligible to be claimed in tax years 2014, 2015 and 2016.

Section 15 – Amends 68 O.S. § 2357.46 (**Credit for Eligible Expenditures Incurred by a Contractor in the Construction of Energy Efficient Residential Property**) by eliminating the credit for tax year 2017 and all subsequent tax years. Also eliminates the transferability of

this credit beginning tax year 2014, but provides the credit may be refundable at an amount equal to 80% of the amount eligible to be claimed in tax years 2014, 2015 and 2016.

Section 16 – Amends 68 O.S. § 2357.47 (**Credit for Eligible Wages Paid by an Employer to an Injured Employee and Credit for Modification Expenses Paid by an Employer for an Injured Employee**) by eliminating the credit for tax year 2015 and all subsequent tax years.

Section 17 – Amends 68 O.S. § 2357.81 (**Investment Incentive Credit**) by eliminating the credit for tax year 2015 and all subsequent tax years.

Section 18 – Amends 68 O.S. § 2357.101 (**Film and Music Profit Reinvestment Credit**) by eliminating the credit for tax year 2015 and all subsequent tax years.

Section 19 – Amends 68 O.S. § 2357.102 (**Dry Fire Hydrant Credit**) by eliminating the credit for tax year 2015 and all subsequent tax years.

Section 20 – Amends 68 O.S. § 2357.104 (**Credit for Eligible Taxpayer's Qualified Railroad Reconstruction or Replacement Expenditures**) by eliminating the credit for tax year 2017 and all subsequent tax years. Also eliminates the transferability of this credit beginning tax year 2014, but provides the credit may be refundable at an amount equal to 80% of the amount eligible to be claimed in tax years 2014, 2015 and 2016.

Section 21 – Amends 68 O.S. § 2357.203 (**Specially Trained Canine Credit**) by eliminating the credit for tax year 2015 and all subsequent tax years.

Section 22 – Amends 68 O.S. § 2357.402 (**Electric Vehicle Manufacturers Credit**) by eliminating the credit for tax year 2015 and all subsequent tax years

Section 23 –

- Amends 68 O.S. § 2358 (A)(8) by eliminating the deduction for wages used to compute the **federal Indian wage** credit for tax year 2015 and all subsequent tax years.
- Amends 68 O.S. § 2358 (A)(9) by eliminating the deduction for **OSHA Safety Pays Consultation Services** for tax year 2015 and all subsequent tax years.
- Amends 68 O.S. § 2358 (C)(1) by eliminating the exemption for **transfers of technology to qualified small businesses** located in Oklahoma for tax year 2015 and all subsequent tax years.
- Amends 68 O.S. § 2358(E):
 1. For tax year 2015, limits the Oklahoma **personal exemption**. All returns with Oklahoma adjusted gross income less than or equal to \$35,000 (\$70,000 for married filing joint) can continue to claim the full personal exemption of \$1,000 per exemption. Returns with Oklahoma adjusted gross income above these threshold amounts and with 4 or more personal exemptions, can also claim the full value of \$1000 per exemption. Personal exemptions will not be allowed for taxpayers with Oklahoma adjusted gross income above these threshold amounts and with 3 or fewer personal exemptions. (The blind exemption and the special exemption for persons over 65 years of age are still allowed as under current law.)
 2. For tax year 2015 and subsequent tax years **itemized deductions** are limited to 80% of the itemized deduction value if federal adjusted gross income is greater than \$100,000 (\$200,000 for married joint filers and head of household filers).

3. For tax year 2015 and subsequent tax years, the **dividend / interest income exclusion** is eliminated.
4. For tax year 2015 and subsequent tax years, **depreciation for swine or poultry producers** is eliminated.
5. For tax year 2015 and subsequent tax years, the **exemption for Oklahoma Police Corps Scholarships** is eliminated.
6. For tax year 2015 and subsequent tax years, the **deduction for human organ donation** is eliminated.
7. For tax year 2015 and subsequent tax years, the **deduction for livestock show scholarships** is eliminated.
8. For tax year 2015, **state and local taxes** included in itemized deductions must be added back into taxable income (by subtracting them from itemized deductions).

Section 24 – Amends 68 O.S. § 2358.3 - For tax year 2015 and subsequent tax years the **deduction for political contributions** is eliminated.

Section 25 – Amends 68 O.S. § 2370 (**Credit for Financial Institutions Making Loans under the Rural Economic Development Loan Act**) by eliminating the credit for tax year 2015 and all subsequent tax years.

Section 26 – Amends 68 O.S. § 2370.3 (**Credit for Stafford Loan Origination Fee**) by eliminating the credit for tax year 2015 and all subsequent tax years.

Section 27 – Amends 68 O.S. § 54006 (**Oklahoma Research and Development Incentives Credit**) by eliminating the credit for tax year 2015 and all subsequent tax years.

Section 28 – Amends 74 O.S. § 5075 – (**Credit for Small Business Incubators – Sponsors**) by eliminating the credit for tax year 2015 and all subsequent tax years.

Section 29 – Amends 74 O.S. § 5078 – (**Credit for Small Business Incubators – Tenants**) by eliminating the credit for tax year 2015 and all subsequent tax years.

Section 30 – Repeals 68 O.S. § 2357.29 **Tornado Tax Credit**.

Impact Methodology and Tables:

Under current law, Oklahoma has a progressive individual income tax rate structure with the top marginal tax rate at 5.25% for tax year 2012. This proposal would provide for a top marginal tax rate of 5.25% for tax years 2013 and 2014, and 4.75% for tax year 2015 and all subsequent tax years. This proposal also limits personal exemptions (subject to income limits), limits the amount of itemized deductions, and eliminates a variety of credits, deductions and exclusions for tax year 2015 and all subsequent tax years.

The data for the current model is from tax year 2010 individual income tax returns, simulating certain growth assumptions for tax years 2015 through 2017. Individual income tax revenue is estimated for tax years 2015 through 2017 under current law; and then estimated for each tax year under the proposed law changes. The difference is then calculated, resulting in the estimated impact by tax year. The results from the Oklahoma Individual Income Tax Micro-Simulation Model are then adjusted to account for certain credits that are not calculated in the model.

Table 1 below shows the conversion from a tax year to a fiscal year for the rate change and the changes to deductions and exemptions.

TABLE 1 - FY CONVERSION INCOME TAX RATE CHANGE AND DEDUCTIONS/EXEMPTION CHANGES¹

Fiscal Impact			
Tax year 2014*			\$0
Tax year 2015			\$(119,093,000)
Tax year 2016			\$(132,122,000)
FY CONVERSION		FY15	FY16
Tax year 2015	\$(119,093,000)	\$(47,637,000)	\$(71,456,000)
Tax year 2016	\$(132,122,000)		\$(52,849,000)
	FY TOTAL	\$(47,637,000)	\$(124,305,000)

¹Under this proposal, the rate change and the changes to deductions and exemptions are effective for tax year 2015 and subsequent tax years, therefore no tax year 2014 effect was modeled.
Source: Oklahoma Individual Income Tax Micro-Simulation Model

* Tax year 2014 has a cost to income tax of \$9,872,000 due to converting certain transferable tax credits to refundable.

Table 2 below shows the fiscal year effect when the changes to a variety of tax credits are considered.

TABLE 2 - ADJUSTMENTS TO MICRO-SIMULATOR OUTPUT			
	FY14	FY15	FY16
Initial Result from Micro-Simulation	\$0	\$(47,637,000)	\$(124,305,000)
Adjustments:			
ITC (Savings by Eliminating Investment)	\$0	\$0	\$10,843,000
Savings of Sunsetting Certain Tax Credits	\$0	\$0	\$1,007,000
Cost of Refunding Certain Tax Credits	\$0	\$(9,872,000)	\$(9,872,000)
Insurance Premium Tax Savings - Income Tax Credits	\$0	\$7,105,000	\$7,105,000
Insurance Premium Tax Savings - Home Office Credit	\$0	\$6,849,000	\$6,849,000
Net FY Effect	\$0	\$(43,555,000)	\$(108,373,000)

Table 3 below shows the net FY effect split between income tax and insurance premium tax.

TABLE 3 - FY IMPACT SPLIT BETWEEN INCOME TAX & INSURANCE PREMIUM TAX			
	FY14	FY15	FY16
Income Tax	\$0	\$(57,509,000)	\$(122,327,000)
Insurance Premium Tax	\$0	\$13,954,000	\$13,954,000
TOTAL	\$0	\$(43,555,000)	\$(108,373,000)