

## MEMORANDUM

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OKLAHOMA TAX COMMISSION  
TAX POLICY AND RESEARCH

DATE: February 19, 2016

SUBJECT: SB 1073 - Committee Substitute (Req. No. 3154)

TO: Joe Gappa, Deputy Director

FROM: Michael C. Kaufmann, Tax Policy Analyst

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The Committee Substitute for SB 1073 (Req. No. 3154) proposes to amend the implementation of the top marginal individual income tax rate of 5% for tax year 2016 and to amend the trigger mechanism to reduce the top marginal individual income tax rate from 5.25 % to 5% and to add a second trigger to reduce top marginal income tax rate from 5% to 4.85% (contingent upon certain revenue growth) in future tax years. This measure further amends 68 O.S. § 2358 as it relates to itemized deductions.

### **CURRENT LAW:**

#### **Income Tax Rate & Trigger:**

Under current law, the top marginal individual income tax rate of 5% went into effect for tax year 2016<sup>1</sup>, with a trigger mechanism in place to potentially lower the top marginal individual income tax rate to 4.85%. In order to trigger the 4.85% rate, the State Board of Equalization, at the December 2016 meeting, will have to make a preliminary finding that the Board anticipates a finding will be made at the February 2017 meeting the estimated growth in General Revenue Collections for the next FY (FY18) is *equal to or greater than* the estimated cost of decreasing the top marginal individual income tax rate to 4.85% for the tax year beginning the second subsequent January (tax year 2018). The State Board of Equalization will then have to certify at the February 2017 meeting the estimated growth in General Revenue Collections for FY18 will be *equal to or greater than* the estimated cost of decreasing the top marginal individual income tax rate to 4.85% for tax year 2018.

If the State Board of Equalization makes a finding at the December 2016 meeting that the Board anticipates a finding will be made at the February 2017 meeting that the estimated growth in General Revenue Collections for the next FY18 is *less* than the estimated cost of decreasing the top marginal individual income tax rate to 4.85% for the tax year 2018, the income tax rate will remain at 5%. These procedures will be repeated at every December and February State Board of Equalization meeting until the top marginal individual income tax rate is 4.85%. Once that rate is achieved, the State Board of Equalization will no longer have to make the findings as outlined

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<sup>1</sup> Finding of the State Board of Equalization – December 18, 2014; *State Board of Equalization Proposed FY-2016 Revenue Certification* - Oklahoma Office of Management and Enterprise Services.

above.

### **Itemized Deductions:**

Under current law, taxpayers that claim itemized deductions for federal income tax purposes can claim the same amount to calculate Oklahoma taxable income. These itemized deductions include state and local taxes paid.

### **PROPOSED LAW:**

#### **Income Tax Rate & Trigger:**

This measure proposes to void the 5% top marginal individual income tax rate if said rate became effective during a fiscal year when a revenue failure is subsequently declared by the State Board of Board Equalization pursuant to paragraph 7 of Section 23 of Article X of the Oklahoma Constitution.

This measure also requires the 2 step trigger as outlined above – creating the top marginal individual income tax rate of 5% after a finding of the State Board of Equalization before the top rate can go to 4.85%. In addition the trigger mechanism required to decrease the top marginal individual income tax to 4.85% would require a 3% growth in the revised General Revenue Fund estimate.

#### **Itemized Deductions:**

This measure proposes to require state and local income or sales taxes included in itemized deductions be added back to calculate Oklahoma taxable income (by subtracting them from itemized deductions).

### **REVENUE IMPACT:**

Under current law, Oklahoma has a progressive individual income tax rate structure with the top marginal individual income tax rate at 5.0% for tax year 2016 and 2017, then *potentially* to 4.85% for subsequent tax years, contingent upon certain revenue growth as outlined above. This measure would set the top marginal individual income tax rate to 5.25% for tax year 2016 and subsequent tax years. This estimate is the effect of the top marginal income tax rate at 5.25% and requiring state and local taxes included in itemized deductions be added back to calculate Oklahoma taxable income. There is an unknown potential increase<sup>2</sup> to FY16 income tax collections. For FY17 individual income tax collections are expected to increase by \$290,780,000. Fiscal Year 18 individual income tax collections are expected to increase by \$248,074,000.

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<sup>2</sup> Individual income tax collections are generally split into fiscal years using a 40% / 60% ratio. That assumes full compliance with the law on January 1 of the tax year. Upon enactment of the top marginal individual income tax rate of 5.25%; the Oklahoma Income Tax Withholding Tables would be adjusted to account for the new rate. The date this might occur as well as compliance is uncertain. It is estimated no more than an additional \$16 million in individual income tax collections could occur in FY16 as a result of the rate change.