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OKLAHOMA'S REVENUE OPTIONS FOR A BETTER BUDGET

Oklahoma is once again facing a massive budget shortfall. According to preliminary estimates, lawmakers will have about \$740 million less for next year's budget than what they appropriated this year. The state budget has already been cut almost 15 percent over the past decade when adjusted for inflation — for a total spending reduction of more than \$1.1 billion per year. Many agencies now receive 20 to 40 percent less than prior to the Great Recession.

The state needs more revenue to avoid more devastating cuts, to ensure fair pay for our teachers and state employees, to close gaps in mental health and substance abuse treatment, and to address critical staffing shortages in our corrections facilities, among other urgent needs. As Oklahoma's Finance Secretary Preston Doerflinger has said, "We are not cutting our way out of this budget hole. We have to have a serious conversation about revenue in this state."



Governor Fallin and other state leaders have acknowledged that a responsible solution must be primarily based on recurring revenues to avoid increasing Oklahoma's structural budget gap. We should also not deepen the regressivity of our tax system for households already facing the toughest economic struggles. When pursuing revenue options like a cigarette or gas tax increase, these should be balanced by measures to strengthen broad-based tax credits like the Earned Income Tax Credit and Sales Tax Relief Credit.

Here is a broad menu of revenue options that are worth considering to ensure a better budget and a stronger economy that works for all. We include revenue estimates where available.

Recurring Revenue Options

- **Assess a high-income surcharge.** Oklahoma has cut the top income rate from 6.65 percent to 5 percent since 2004. These cuts have contributed to chronic budget shortfalls by reducing annual revenue by over \$1 billion. A large majority of the benefit has gone to the highest-income households. Oklahoma could assess a surcharge of 6 percent on income over \$200,000 (\$100,000 for single individuals) and 7 percent on income over \$400,000 (\$200,000 for singles). Only 3 percent of households would be affected by the surcharge. Even after this change, all households would be paying less income taxes compared to before recent tax cuts [REVENUE: \$204M].
- **End the capital gains exemption.** Oklahoma allows a 100 percent income tax deduction on capital gains from the sale of property located in Oklahoma or the sale of stock of a company headquartered in Oklahoma. The tax break, which primarily benefits taxpayers making over \$1 million annually, is of questionable economic benefit and could also violate the Commerce Clause of the U.S. Constitution [REVENUE: \$105M].
- **Adopt combined corporate reporting.** Some multi-state corporations shift income to out-of-state subsidiaries to escape state tax liability. Most states with a corporate income tax have adopted an effective and well-established reform known as combined corporate reporting that halts this tax avoidance strategy and ensures that multi-state corporations pay their fair share of taxes, just like local businesses [REVENUE: ~ \$20M - \$60M].
- **Increase the cigarette tax.** Last session legislators came close to raising the tax on cigarettes to \$2.53 from \$1.03 per package. Revenue from a cigarette tax increase could be dedicated for health care services to reverse past cuts and avert further ones [REVENUE: \$258M, according to Gov. Fallin's FY '18 budget proposal].

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- **Increase the fuel tax.** Oklahoma has among the lowest fuel taxes in the nation (17¢ per gallon for gas and 14¢ per gallon for diesel), and it has not been adjusted since 1987. Since that time the fuel tax has lost nearly half its value to inflation. Fuel tax increases could be pegged to be in effect only when gas prices are low. This would offset the loss in gross production taxes that Oklahoma experiences during times of low oil and gas prices [REVENUE: \$135M for 5¢ increase of gasoline and diesel tax; \$220M for Gov. Fallin's recommendation to increase both gas and diesel tax to 24¢ per gallon].
- **Improve collection of Internet sales taxes.** States are hampered from collecting taxes on sales from retailers that lack a physical presence in their state – even though the tax is owed. Last year lawmakers passed a bill (HB 2531) that included a broader definition of who maintains a place of business in the state and also required remote retailers to send customers an annual statement listing their purchase. Oklahoma could now follow the lead of Colorado and Louisiana by also requiring remote retailers to notify the Tax Commission of their customers' aggregate sales, which would boost compliance [REVENUE: Unknown].
- **Expand the sales tax base.** The state could increase sales tax collections through some combination of ending existing exemptions on the sale of goods and broadening the sales tax to include more services. Last year, Governor Fallin proposed ending exemptions on sales to commercial airlines, advertising sales, tickets to professional sporting events, and other goods [REVENUE: \$112 million]. Governor Fallin's FY '18 budget proposed expanding the sales tax to all services that are currently untaxed in Oklahoma [REVENUE: up to \$839M].
- **Reduce tax breaks for gross production.** Oklahoma traditionally has taxed oil and gas production at 7 percent with various exception rates. In 2014, the Legislature voted to tax almost all production at 2 percent for 36 months, which is well below the tax rates in other energy-producing states. This tax break is expected to cost the state \$370 million in FY 2018. The gross production tax rate on new production could be raised to 4 percent when prices are low and back to 7 percent when prices are higher. This would have a limited impact in FY 2018 but would increase over time [REVENUE: up to \$500M].
- **Curb subsidies for wind producers.** Oklahoma currently provides various tax breaks for wind production, including a zero-emission tax credit that provides \$0.005 per kWh of generated wind. As wind production has expanded, the cost of the credit has increased. The credit is slated to end in 2020 but could be eliminated earlier or capped at a set amount. Even if the credit is ended, the state would have continued liability for credits accrued in prior years, but payments could be deferred until revenues recover [REVENUE: ~\$35M - \$80M].

One-time Revenue Options

Last year, the Legislature used over \$600 million in one-time revenues to balance the FY 2017 budget. These measures averted even deeper budget cuts but were responsible for the lion's share of this year's budget shortfall. Some cautious use of one-time revenues should be considered again for FY 2018.

- **Tap the Rainy Day Fund.** Of the \$243 million that's left in the Rainy Day Fund, \$91 million (3/8ths) can be tapped for the FY 2018 budget with a simple majority vote of the Legislature. Another \$60 million (1/4) is available upon declaration of an emergency, which requires either a 2/3rd vote of both legislative chambers if the Governor declares an emergency or a 3/4ths legislative vote without the Governor's consent [REVENUE: Up to \$151M].
- **Defer increases to the ROADS Fund.** The ROADS Fund for highway and bridge maintenance is slated for an automatic \$59.7 million increase in FY 2017, bringing its total to \$576.7 million annually. The Legislature could defer that increase, which would lead to some maintenance and repair projects being delayed [REVENUE: \$59.7M].
- **Issue bonds for transportation projects.** Last year the Legislature authorized \$200 million in transportation bonds, which allowed money that would otherwise be appropriated to the Department of Transportation to be used for other purposes. Bonds could be issued again this year to help fill the budget hole [REVENUE: up to \$250 million].

Other one-time revenue sources, such as transfers from agency revolving funds and the Unclaimed Property Fund, should also be considered.