OCPA

Memorandum

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Subjecting Tax Cuts to SQ 640 Will Result in a Massive Tax Increase

In 1992, Oklahoma voters approved State Question 640 to add a taxpayer-protection provision to the state Constitution. The constitutional amendment requires bills creating or raising taxes, or creating new revenue streams for the general purpose of funding government, to originate in the House of Representatives, as well as be submitted to a vote of the people or receive three-fourths approval by both legislative bodies. In addition, the legislation must be passed prior to the last five days of the legislative session.

The constitutional amendment was a direct response from citizens following tax increases and spending hikes. Everyone — supporters and opponents alike — understood the provision would make it harder to raise taxes. That was the point. That is what a plain reading of the law says. That is what voters approved at the ballot box 22 years ago.

Recently, state Supreme Court justices heard arguments regarding the constitutionality of Senate Bill 1246, which cuts the state personal income tax if revenue targets are met. Those who oppose personal income tax cuts in Oklahoma are voicing their support for this challenge.

Several have analyzed the legal arguments of the lawsuit before the Oklahoma Supreme Court regarding SQ 640. This document projects the actual impact on the citizens of Oklahoma of a potential ruling that tax cuts are subject to the requirements of State Question 640. Even if the decision is not retroactive, the impact on this year's and future years' tax filings is significant, especially for certain individuals. Here is a general overview of many of the previous tax cuts that could be ruled unconstitutional or challenged, as they were enacted in a manner that did not meet the three requirements of SQ640 for tax increases.[i]

- 1998 reductions of the state's personal income tax rate from 7.00 percent to 6.75 percent
- 2005 reductions of the state's personal income tax rate from 6.65 percent to 6.25 percent
- 2006 reductions of the state's personal income tax rate from 6.25 percent to 5.25 percent
- 2005 manufacturing exemption against the state's corporate income tax for distributors
- 2014 setting of the state's gross production tax rate at 2 percent for all new oil and natural gas wells drilled in the state, for the first three years of a well's production
- 2005 repeal of Oklahoma's estate tax
- 2005 tax relief for all disabled veterans filing personal income tax returns in Oklahoma
- 2006 tying of the state's standard deduction for taxpaying families to match the federal standard deduction
- 2006 tax relief for all private-sector retirees filing personal income tax returns in Oklahoma
- 2006 tax relief for all veterans filing personal income tax returns in Oklahoma
- 2008 tax credits for aerospace engineers and aerospace employers
- 2014 extension of tax credits for aerospace engineers and aerospace employers

Clearly the vast majority of Oklahomans are going to be negatively impacted on a prospective basis by a ruling of unconstitutionality, even if the Court does not rule the tax cuts will be undone on a retroactive basis. A retroactive ruling would be an administrative nightmare. For example, would the beneficiaries of estates now be considered to be subject to collection of the back taxes the estates would now owe? Would those retirees who have been living in Oklahoma now be subject to recapture of the tax on the income that was excluded by the increase of their deductions from $5,500 up to the current $10,000?

The following are some examples of the impact to certain types of individuals who benefit from current tax provisions that were the result of legislatively enacted tax cuts that failed to meet the three requirements of State Question 640.

Disabled Veterans Could See Annual Tax Hikes of $500 or More

For a single disabled veteran living off of $36,000 of Adjusted Gross Income (AGI), after losing the benefit of the current provisions that exclude the first of $10,000 of their disability income and the current 5.25% rate, that disabled veteran will now pay approximately $500 more in taxes.[ii]

Surviving Spouse of a Member of the Armed Forces Killed in Action Could See Annual Tax Hikes

Effective in 2010, any payment made by the United States Department of Defense to a surviving spouse of an Armed Forces member killed in action was exempt from Oklahoma income tax during the taxable year they died. The spouse's income was also exempted from Oklahoma income tax during that year in which their loved one died in military action. Both of those provisions failed to meet the requirements of SQ640.[iii]

Active Military Personnel Could See Annual Tax Hikes

Active military personnel may find themselves similarly being punished. Currently, salary or compensation earned as a member of any component of the Armed Forces of the United States on or after July 1, 2010, by military servicemen and women can be subtracted from Oklahoma AGI.[iv] This provision was enacted with legislation that failed to meet the requirements of SQ640.

Senior Citizens and Retirees Could See Annual Tax Hikes of $1,000 or More

For senior citizens and retirees, the impact would be felt in several areas. Many retirees who currently qualify for the existing exclusion of $10,000 of retirement income from Oklahoma individual income taxation will now be prohibited from this benefit because their income is too high. A retired couple making $51,000 with $10,000 of retirement income would now be subject paying approximately $1,000 more in state income taxes.[v]

Middle-Class Families Could See Annual Tax Hikes of $900 or More

Oklahoma families would be impacted as well. Consider a family of four: one parent is a teacher and the other a social worker, with a combined $75,000 of AGI. This family would find that they will owe nearly $900 in additional tax to the State of Oklahoma.[vi]

Single Moms Could See Annual Tax Hikes of $200 or More

Single mothers and their children would now find they too have less money for essentials. Due to the loss of standard deductions and an increase of the rate, a single mother with two children could experience tax increases of $200 or more.

Farmers Could See Significant Estate Tax Hikes

The estate tax was eliminated in 2010 but could now be immediately re-implemented. This is particularly onerous in a state with both farming and agricultural industries like Oklahoma, where it now takes large tracts of land to support a family. Many family farms have large amounts of "value" in tracts of land but not a significant amount of assets easily convertible to cash for the liquidity to pay a large, one-time estate tax bill. Consider a farmer/rancher with 3,200 acres of land in Custer County who dies without any chance to do long-term planning because of the unforeseen action of the reinstated estate tax. If the farmer/rancher's land is valued at the average value received in Oklahoma in 2013 of $1,750 per acre[vii] on sales (pure crop land would be much higher), the estate would now owe a bill of more than $400,000.[viii]

More Costly Lawsuits Will Ensue, Requiring Taxpayers to Pay Billions

If the impact on these citizens is not enough, there are ancillary impacts the Court may not have even considered. There are a number of dedicated state funds that are derived from a dedicated portion of individual income taxes and automatically allocated without annual legislative appropriations to various functions of government, including common education. Public school interests or other interests who believed they were statutorily entitled to certain revenue amounts have successfully sued when the case could be made they were owed funds as a result unconstitutional action.

For example, the Oklahoma Teachers Retirement System (OTRS) receives five percent of sales taxes, use taxes, corporate income taxes, and individual income taxes. In the tax year 2014, more than $162 million[ix] went directly to OTRS from individual income tax receipts based on that five percent. The OTRS Board could assert that their fiduciary duty to OTRS requires them to file suit for the funds that were not provided to the system over the period the "unconstitutional" tax cuts were in effect. Included in this amount of "lost" funding would be the value of OTRS's returns on investments.

To cite another example, the Education Reform Revolving Fund (or House Bill 1017 fund, as it is generally known) was created by House Bill 1017. That law increased the sales tax from 4 percent to 4.5 percent, increased the corporate income tax rate from 5 percent to 6 percent, and added a new top rate for individual income taxes of 7 percent (previously the top rate was 6 percent). The 7 percent rate generally applied to $21,000 of taxable income for those filing joint returns and at $10,000 for single filers.[x] The income tax portion of HB 1017 dedicated more than $303 million to schools in 2014, making it the largest single dedicated fund from that source.[xi] Those seeking to increase revenues for public education could assert and sue that the 1017 fund has been hurt by personal income tax cuts the State Supreme Court might rule now unconstitutional.

Note: These scenarios are based upon applying tax statutes and regulations prior to approval of amendments to applicable statutes that did not meet the requirements of State Question 640. The intention and purpose of these scenarios is to provide a public policy analysis of current public policy discussions. It is not specific tax advice or related legal counsel. Persons seeking specific tax advice or legal counsel should seek specific and/or professional services as it pertains to their particular tax compliance needs.

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[i] Condensed from several sources; may not be complete for all taxes that will be rolled back
[ii] Assumes no other deductions or credits after AGI, using the tax tables provided by the Oklahoma Tax Commission at http://www.tax.ok.gov/
[iii] http://www.tax.ok.gov/rules/rule5010.pdf
[iv] http://www.tax.ok.gov/rules/rule5010.pdf
[v] Assumes no other deductions or credits after AGI, using the tax tables provided by the Oklahoma Tax Commission at http://www.tax.ok.gov/
[vi] Assumes no other deductions or credits after AGI, provided by the Oklahoma Tax Commission at http://www.tax.ok.gov/
[vii] http://agecon.okstate.edu/oklandvalues/county_annual.asp
[viii] http://www.tax.ok.gov/forms/45499.pdf
[ix] Oklahoma Tax Commission, Tables of Apportionment for 2014
[x] http://www.ocpathink.org/articles/840
[xi] Oklahoma Tax Commission, Tables of Apportionment for 2014