

Business Tax Cut Threatens State Revenue

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by Kwamena Blankson, Arise Policy Analyst

Alabama will lose about \$90 million in state education revenue by 2004 because of a new provision of federal tax law that reduces state income taxes on corporations and individuals in nearly every state. Reducing the expected revenue from these long-standing Alabama taxes will only add to our financial problems at a time when the state already is struggling to balance its education budget and prevent a second year of proration.

Signed into law on March 9, 2002, the “bonus depreciation” provision of President Bush’s economic stimulus plan allows a business to claim an immediate tax deduction of up to 30% of the cost of new equipment purchases of at least \$24,000. This added bonus was effective retroactive to September, 2001, so that businesses could begin to claim the deduction on their tax returns for 2001 and their estimated tax payments due in 2002. Under previous federal law, the full cost of such equipment would have been depreciated gradually over several years.

By the time the bonus depreciation provision expires in September, 2004, it will have reduced federal revenue from taxes on profitable businesses by about \$97 billion and could also cost states a total of \$14 billion in corporate and individual tax revenue over three years.

Since the late 1980s, nearly all states have used the federal definition of taxable business income – including the federal allowance for depreciation – as the basis for their own tax calculations. But in response to the new tax deduction created for bonus depreciation, many states have moved quickly to discontinue their conformity to the federal code. Unfortunately, Alabama has taken no steps to prevent such revenue losses and thus automatically conforms to the federal change.

In fact, because of the retroactive effect of the new provisions, Alabama is experiencing immediate revenue losses. Already, businesses have been allowed to claim the bonus allowance for tax year 2001. This tax break for businesses comes on the heels of last December’s special session when legislators were faced with the aftermath of last year’s 6.2% proration of the education budget.

In light of the precarious finances of our schools, lawmakers could have taken immediate steps this spring to limit the loss of millions of dollars in business tax revenues. But with the end of the 2002 legislative session, legislators missed that opportunity.

Fortunately, Alabama can protect itself from further losses. The state can enact legislation next March to “decouple” its business depreciation rules from the federal rules while the bonus depreciation is in effect. Alabama can simply link its corporate income taxes to the federal tax code in effect prior to September, 2001.

Leaving Alabama behind again, our neighbor to the west – Mississippi – has chosen

to lead rather than follow in this decoupling initiative. Historically, a Mississippi regulation allowing “reasonable allowance” for depreciation has consistently prompted the state to adopt the federal depreciation rules. Mississippi’s revenue commissioner simply determined that the new bonus depreciation provision is in fact *not reasonable*, and his official ruling has decoupled Mississippi from the federal rules.

Thus far, 28 states and the District of Columbia have decoupled from the federal depreciation rules in the short time since the federal legislation passed. Most had already decoupled in the 1980s after Reagan’s 1981 tax law first created “accelerated depreciation” and proved to be a huge tax break only for large corporations.

Now, faced with this reincarnation of the accelerated depreciation law, Alabama can choose to decouple from the federal change and thus avoid losing revenue. Any complications that could be attributed to decoupling will be short-lived since the federal change expires in less than three years. More importantly, there will probably be no impact on small businesses, since the provision only applies to new equipment purchases totaling \$24,000 per year or more. These new depreciation rules are essentially a tax cut for large corporations, which already enjoy an Alabama deduction for federal income taxes paid.

The question is whether Alabama can afford to give large businesses yet another tax break when the state budget is already stretched thin.

According to the Legislative Fiscal Office, the terrorist attacks of September 11, 2001, “put a new wrinkle in the economy,” deepening the effect the recession has had on Alabama’s sagging revenues. In the wake of the attacks, State School Superintendent Ed Richardson warned that another year of even 3% proration (a cut of \$128 million) “would have an absolutely devastating impact.”

In order to deal with its budget shortfall for next year, the Legislature put makeshift financial supports in place, poorly buttressing the FY 2003 budget with about \$100 million in one-time transfers and allocations to the General Fund. Do we want to mismanage the Education Trust Fund as well, thereby jeopardizing our children’s future?

Alabama is now on thin ice as we continue to borrow from the future to pay for the past. We cannot afford to put Alabama’s under-funded schools at further risk by relinquishing these corporate tax revenues. But there is another reason to halt expanding corporate income tax breaks:

This is a matter of fairness – expecting larger businesses to shoulder their fair share of the overall tax burden. Already the Bush tax cut plan exacerbated the unfairness of the tax code. The Center on Budget and Policy Priorities reports that only 12.7% of the tax-cut benefits will go directly to the 60% of families with the lowest incomes; less than 30% of the benefits will go to the bottom 80% of families. At a time when many lower and middle-income Alabamians have found themselves actually losing resources essential for survival, it is unfair to ask them to bite the bullet – losing access to basic services and tolerating underfunded schools – while we lavishly line deep corporate pockets.

And let us be clear: decoupling will not cause a tax increase for large businesses. Alabama will simply be *preserving* an existing tax. Keeping this revenue

may help Alabama continue funding education with less threat of proration in the near future. Even now, school systems and universities have not fully recovered from last year's disastrous 6.2% proration. Funding for FY 2003 will still not restore the income level of FY 2001.

Bonus depreciation is a temporary change that could do lasting damage to Alabama's budget, education programs, and most importantly the state's young citizens. No matter what action Alabama takes, the federal changes will continue to benefit corporations at the expense of the rest of the population. But by decoupling from the changed federal rules, the state will be better able to provide an adequately funded education system, thereby ensuring a better future for our youth.

The legislature's failure to address this issue in a timely manner should also serve as a wake-up call to Alabamians. Those of us who do not have enough money to control political decisions in this state should use our power as citizens wisely. Together, our votes can help ensure that we will be represented by legislators who will act in the best interests of all Alabamians, not just the well-to-do.

Sources:

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Arise Citizens' Policy Project

P. O. Box 1188

Montgomery, AL 36101

(334) 832-9060

www.arisecitizens.org