

## **GOVERNOR RILEY'S TAX PROPOSAL:**

### **A REFORM PACKAGE FOR ALL SEASONS**

On Monday, May 19, Governor Bob Riley unveiled a \$1.2 billion tax and education reform package that could change Alabama's future, building a world class education system. Governor Riley's announcements of cut-back measures to restore public confidence in government have taken a short hiatus while the Governor and the Legislature try to find a way to produce additional revenue to fund our education system. Now that this long journey has begun, the lawmakers of Alabama must diligently move this proposal through the Legislature for approval in a public referendum.

While the Governor's solutions must run the gauntlet laid by the special interests roaming the halls of the Statehouse, Governor Riley carries credentials uniquely qualifying him for this task. In 2002, Riley, while serving in the United States Congress, was awarded the "Friend of the Taxpayer Award" by the Americans for Tax Reform for his anti-tax stance, in never once voting for a tax increase. Now, as Alabama's Governor, he proposes the largest tax increase in our history. A tax proposal of this magnitude by this Governor is a clear indication that our state is in dire need of new

revenue. The proposed reforms can move the mortally wounded education budget from the battle aid station to Walter Reed Hospital.

Components of the tax package reveal a fair plan that would adequately fund education and state government by raising the revenue from those most able to pay. Included in the revenue measures are equitable reforms and revenue generating measures spread across the gamut of our tax system: \$415 million from personal income tax, \$425 million through ad valorem tax; \$50 million in additional corporate income taxes, insurance premium taxes and bank excise taxes; \$45 million from increased mortgage and deed recording taxes, and \$212 million in increased cigarette taxes, a new intangibles tax, a repair and installation tax and higher automobile sales and license taxes.

For our tax system to be truly reformed, the end product must be fair, efficient, reliable, simple, transparent, adequate, and revenue-positive. These criteria were recently adopted by the Citizens' Commitment, a tax reform group comprised of a coalition of Alabama charities, to measure the progressiveness of the Governor's tax proposal. These criteria have been used by many progressive states to bring fairness and order to state taxation, and properly fund state services.

Alabama now has an opportunity to join the ranks of Georgia, North Carolina and Mississippi by reforming our tax system once and for all.

How does the Governor's proposal measure up to this test for a sound and reasonable tax system? Very well indeed.

**A. A PROGRESSIVE AND REVENUE POSITIVE INDIVIDUAL INCOME TAX.**

Under the Governor's personal income tax proposal, Alabamians will enjoy a more progressive and fairer tax system. The family of four that earned \$4,600 and paid tax this year would not pay tax next year unless it makes \$17,000. This threshold increases over three years until it reaches \$20,000. The loss of revenue created by this needed reform is offset by the elimination of the individual Federal income tax deduction, discussed below, and a one percent rate increase to 6% for those earning more than \$75,000 individually or \$150,000 as a family. This is a fair measure that relieves those least able to pay from a long time unfair tax burden.

The Governor proposes to eliminate the state Federal Income tax deduction for individuals and corporations. This proposal is revenue-positive and is a fair measure that's long overdue. Alabama is one of only three states that allow the full deduction of Federal income taxes. Two other

states allow a fifty-percent deduction, and the rest of the Country eliminated the deduction long ago.

The net revenues generated by individual income tax reforms are estimated to be over \$400 million.

## **B. GETTING PROPERTY TAXES IN LINE WITH SISTER STATES**

Raising property taxes! Much like eliminating the Federal income tax deduction, this impacts individuals and corporations evenly. Alabama's property tax does not provide adequate revenue for state services. What Alabamians need to realize is our state is underfunded, and it is largely due to our embarrassing property taxes, which are the lowest in the Nation.

The Governor's property tax reform measures would be the most stable revenue source within the package, and would provide a tax base that is fair, simple, reliable and transparent. All real estate would be assessed at its fair market value, whether it belongs to a utility or a bank. Current use values of farm and timber lands would be raised to their true fair market value, which has only been done once before in twenty years. To protect the small homeowner or farmer, the homestead exemption would be increased from \$4,000 to \$50,000 and the first 200 acres of farm or timber land occupied by the owner would be exempt from the tax increase.

These changes will still leave us competitive with our sister states. Alabama will still have lower property taxes than all of its contiguous neighbors and will be below the Southeastern State average. Time will only tell if the folks speaking for the big landowners will pardon this progressive tax reform bill from the chopping block. The citizens of Alabama should not be afraid to raise property taxes to a level that allows our education system to meet high standards of excellence. These measures are projected to raise \$425 million of new, stable, reliable funding.

**C. TAXING BUSINESSES THE SAME WHETHER**

**THEY MAKE GUNS OR BUTTER.**

As discussed in previous articles, a major flaw of our tax system is its unequal treatment of banks, insurance companies and other businesses. For example, banks get a tax credit for sales taxes they pay, but other businesses only get a deduction, or about 6% of the credit's value to the bank. Insurance companies headquartered in Alabama get special home office breaks not enjoyed by other businesses, and pay a shockingly low premiums tax. Governor Riley's reform package not only requires businesses to pay a share of new tax revenues but seeks to level the business playing field by eliminating these special breaks to the favored few.

The corporate income rate will be raised to the average rate for the Southeast, and banks and insurance companies will see their tax holiday end. The effective corporate rate will move from 4.2% to 6%, by eliminating 75% of the Federal income tax deduction. Banks no longer will be able to claim a tax credit for sales taxes and the insurance company home office deduction would come to an end. This is a step in the right direction as our large banks and insurance companies historically pay little or no tax. These reforms will also recapture lost revenue of many non-banking activities under the banking tax umbrella, such as real estate investment trusts. The new legislation requires insurance companies to at least pay a tax equal to two percent of premiums. This is still low because insurance company profits have been well above two percent. However, it is a progressive measure toward true tax fairness.

Stay tuned on the business tax bills. The well heeled influence peddlers representing these interests in Montgomery have proven themselves savvy at poking holes in business tax buckets. Hopefully, the cajoling of talented and progressive business lobbyists, like those representing the Campaign for Alabama, will keep these bills from emerging as a deficit source instead of a revenue

bucket. If we can continue to close corporate tax loopholes and enforce the existing tax laws these business tax measures could meet all of the credentials of an equitable tax system.

**D. CIGARETTE TAX: SMOKING OUT NEW REVENUE**

Tobacco tax, Riley's hitting the mark again. His proposal to double cigarette tax from 16.5 cents to 33 cents per pack is fair, efficient, and revenue-positive. I left out adequate, as Alabama will still tax cigarette products fifty percent below the national average of 66 cents per pack. If we are truly reforming, we should at least meet national averages. Taxing cigarettes at 66 cents per pack would generate \$125 million compared to the \$50 million increase proposed by the Governor. More importantly, increasing cigarette tax to an acceptable level will decrease the high rate of smoking among Alabama teenagers. Alabama tobacco tax ranks a low 45th nationally, contributing to our high adult smoking rate. Surprisingly, Alabama hasn't seen a tobacco tax increase since 1984.

**E. EVERYONE SHOULD SHARE THE LOAD.**

Other tax raising measures include increased deed and mortgage filing fees, sales tax on automobiles and a tax on intangible property. Also, a bill will be presented that would establish a sales tax on installation and repair services. Although these taxes will be hard to swallow for some lawmakers and many voters, everyone should realize that levies such as these will have to be included if the larger property owners are asked to shoulder a fair share of the burden. Besides, these bills contain plenty of exemptions to salve the pain of most would be taxpayers.

**F. HEAD SCRATCHERS: LINKING ALL REFORMS TOGETHER AND**  
**EARMARKING NEW MONEY**

After all these tax proposals are implemented, Alabama will still have one of the lowest overall tax burdens in the Southeast, and our system will have progressed light years from our current antediluvian scheme. For the first time in our history, we will be able to say that rich and poor, individuals and business, are bearing a fair share of the cost to make Alabama all it can be.

How do we ensure that this wise and equitable package keeps its balance? By linking all parts of the measure together for one, up or down, vote by the people. Governor Riley has done just



that. If the package is blessed by the Legislature, and it is an odds on favorite to be passed, the people will have one amendment to vote on in September, to carry out the income and property tax reforms in the Governor's proposal that require a constitutional amendment.

If the people approve the package, Alabama will never be the same. State School Superintendent Ed Richardson and Governor Riley both predict that we will have a world class education system. But, if the proposal fails, we will be doing what we have done in eight other proration budgets in the past twenty years: searching for short term solutions that do not reform our system.

We understand that all \$1.2 billion in new revenues to be generated by the package will go into a new, unearmarked fund, the Excellence Fund, as long as the General fund and Education Trust Fund first receive their old level of funding. The Legislature, not the Governor, would decide how to use the balance in the Excellence Fund.

Of course, the first \$675 million to \$725 million in the Excellence Fund would cure the looming 2004 deficits in the General and Education Trust Funds, but the remainder is open to debate by the Legislature.

Under this new proposal, the power of the Legislature to appropriate money will be enhanced, and the Governor's powers will be reduced. Let us hope that our lawmakers exercise this new stewardship of our fisc wisely to fund K through 12 initiatives, provide college scholarships to gifted students, and otherwise to advance Alabama's education system.

Like a Mozart symphony, the Excellence Fund would start slowly and simply. In 2004, it may receive \$700 million, or only what is required to cover expected deficits in the General and Education Trust Funds. By 2006 and beyond, the Excellence Fund may receive \$1.2 billion and more annually. The \$500 million in new funding could be used to bring Alabama's schools to National levels.

#### **G. CONCLUSION.**

Like the last major tax reform effort sponsored by Governor Hunt in 1992, this package may be picked apart to find compromises and business friendly one liners to please special interest groups. The Governor's strategy to hold the details of the package until the last minute has been frustrating to lawmakers, lobbyists, and tax reform groups. Do they have enough time to thoroughly

digest the details of the package? Uncertainty can be a negative driver leading our Legislature to vote against the proposal.

Riley's fate now lies with the Legislature and the people of Alabama. He will need help from the many members of the Alabama Education Association and grassroots tax reform groups to have a fair chance at achieving his lofty goals. Riley needs to sell his reforms not only to the working people of Alabama but also to big business, including the large timber owners, powerful insurance companies and wealthy financial institutions. Big business may fight tax increases no matter how bad the State's financial crisis may be. But we, as loyal citizens of Alabama, should support our Governor's monumental effort to invest in the education of our children.

The package before the Legislature is a fair and broad-based program that potentially could move our State light years ahead. Nearly every reform suggested in our previous articles over the past few months would be implemented through the Governor's proposal. Taxpayers of all backgrounds will be given an oar and asked to row. Let's get these bills in front of the people of Alabama to decide our future, post haste.