THE IMPACT OF THE FISCAL CLIFF ON THE STATES

ARKANSAS

Federal and state finances are closely intertwined, and the fiscal cliff's tax and spending provisions will have consequences for states.

TAXES Most state tax systems are linked in some way to federal tax law, and as a result, the fiscal cliff's scheduled tax increases could automatically affect state tax revenues. The magnitude of the direct impact of the specified provisions is currently unknown, but the potential increase or decrease in revenues is noted where possible.

DIRECT IMPACT OF THE FISCAL CLIFF ON STATE TAX REVENUES

Tax Categories:	Personal Income Tax[a]				Corporate Income Tax[e]	Estate Tax
Federal changes under the fiscal cliff:	Increase total federal tax liability	Reduce certain federal personal deductions	Reduce certain federal credits		Reduce certain federal business deductions	Reduce federal exclusion and reinstate federal credit
State linkage to federal policy:	State allows deduction for federal income taxes[b]	State linked to those deductions[c]	State linked to the Earned Income Tax Credit[d]	State linked to the Child and Dependent Care Credit[d]	State linked to those deductions[f]	State linked to those changes[g]
Arkansas	N/A	UNKNOWN	N/A	N/A	UNKNOWN	▲

△ indicates an expected increase in state revenue
▽ indicates an expected decrease in state revenue
N/A indicates the state is not linked to the federal provision or does not levy this tax
UNKNOWN indicates any potential impact could not be identified at the time of writing

SPENDING The scheduled reductions in federal spending could affect some states more than others depending on the make-up of each state's budget and economy.

SELECTED INDICATORS OF STATES' POTENTIAL VULNERABILITIES TO SPENDING CUTS IN THE FISCAL CLIFF

	Federal Grants Subject to Sequester as a Percentage of State Revenue (2010)**	Federal Spending on Procurement, Salaries, and Wages as a Percentage of State GDP (2010)	Federal Defense Spending on Procurement, Salaries, and Wages as a Percentage of State GDP (2010)	Federal Nondefense Spending on Procurement, Salaries, and Wages as a Percentage of State GDP (2010)	Federal Nondefense Workforce as a Percentage of Total Employed in State (2012)
National Average	6.6%	5.3%	3.5%	1.8%	1.0%
Arkansas	6.2%	3.4%	2.4%	1.0%	0.9%

NOTE: The general economic slowdown that could result if the full fiscal cliff were allowed to take effect would likely overwhelm any of the separate impacts. For more information, see notes on page 2.

For the full report and 50-state information, see *The Impact of the Fiscal Cliff on the States* at:

www.pewtrusts.org/fiscal-federalism

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NOTES & SOURCES

[a] The following states do not levy a personal income tax: Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming.

[b] Tax revenue impact in states that allow taxpayers to deduct federal income taxes. Increased federal taxes would lead to higher deductions on the state tax return, and thus lower tax revenue, in these states.

[c] Tax revenue impact in states that are automatically linked to one or more of the various "above-the-line" and "below-the-line" federal deductions that are scheduled to be reduced or eliminated. Lower deductions would lead to higher state taxable personal income, and thus higher tax revenue, in these states. Some states without arrows may be impacted by the scheduled changes. Based on Pew analysis of available sources, the potential impact could not be identified at the time of writing. See *The Impact of the Fiscal Cliff on the States*, endnote 25.

[d] Tax revenue impact in states that are automatically linked to this credit. The scheduled reduction of this credit would lead to higher state taxable personal income, and thus higher tax revenue, in these states. Two additional states had state EITCs in law but the credit was suspended (Colorado) or not yet implemented (Washington) as of 2011. States may be affected by linkages to other federal tax credits scheduled to change under the fiscal cliff that are not addressed in this analysis.

[e] The following states do not levy a corporate net income tax: Nevada, Ohio, South Dakota, Texas, Washington, and Wyoming.

[f] Tax revenue impact in states that are automatically linked to either: 1) federal bonus depreciation rules, or 2) enhanced expensing rules. The scheduled expiration of these provisions would lead to higher state taxable corporate income, and thus higher tax revenue, in the near term in these states. Some states without arrows may be impacted by the scheduled changes. Based on Pew analysis of available sources, the potential impact could not be identified at the time of writing. States may be affected by linkages to other federal corporate income tax provisions scheduled to change under the fiscal cliff that are not addressed in this analysis.

[g] Tax revenue impact in states that are automatically linked to either: 1) the exclusion amount, or 2) the federal credit for state estate taxes. The scheduled reduction in the exclusion amount would lead to an increase in the taxable value of estates, and thus higher tax revenue, in the states linked to the exclusion amount. The scheduled return of the credit would lead to the automatic reinstatement of state estate taxes, and thus higher tax revenue, in the states linked to the credit.

[†] New Mexico's allowable credit is reduced by the amount of the federal credit claimed. Thus, the scheduled federal reduction of this credit would lead to higher state credit amounts claimed, and thus lower tax revenue, in New Mexico.

**Grants calculations exclude funds that would be sequestered in FY 2013 but would be disbursed October 1, 2013, at the start of FY 2014.

*The data for Maryland, Virginia, and the District of Columbia are combined due to the high percentage of commuters in the area.

SOURCES: Institute on Taxation and Economic Policy, *Why States That Offer the Deduction for Federal Income Taxes Paid Get It Wrong*, August 2011; Federation of Tax Administrators, *State Personal Income Taxes: Federal Starting Points*, January 2012, and *Range of State Corporate Income Tax Rates*, February 2012; Tax Credits for Working Families, *States with EITCs*; National Women's Law Center, *Making Care Less Taxing: Improving State Child and Dependent Care Tax Provisions*, April 2011, and February 2012 memorandum, *Developments in Federal and State Child and Dependent Care Provisions in 2011*; Commerce Clearinghouse, *2012 State Tax Handbook*, Chicago, IL: CCH, 2011; Urban-Brookings Tax Policy Center, *Back from the Dead: State Estate Taxes After the Fiscal Cliff*, November 2012. Pew analysis of Federal Funds Information for States, Census Bureau State and Local Government Finances Survey, Bureau of Labor Statistics, Office of Personnel Management, Census Bureau *Consolidated Federal Funds Report*, and Bureau of Economic Analysis data.

The Pew Fiscal Federalism Initiative examines the federal-state relationship and the impact of federal spending, tax policy, and regulatory decisions on the states to enrich policy debates about long-term fiscal stability at all levels of government.

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See also *The Impact of the Fiscal Cliff on the States* at:

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