Good morning Madam Chair and Members of the Committee,

Of the three individual income tax bills discussed today, HB 1425, is the only bill that does not immediately lower the rate or flatten the current five-bracket structure. HB 1425 would lower all marginal tax rates across the current five-bracket structure, revenue permitting, but the earliest the state would likely see rate reductions would be 2025. Unlike HB 1118 and HB 1158, HB 1425 would not immediately contribute to solving North Dakota's labor force challenge. The potential for a flatter system exists, but it would take until at least 2029 to eliminate even the lowest tax bracket. What HB 1425 does offer, relative to the HB 1118 and HB 1158, is a clear path to eliminating the individual income tax.

As I mentioned earlier, policymakers in many states have contemplated the total repeal of their individual income tax. While doing so may stimulate economic activity in their states, that does not mean it is the right or responsible decision for every state. Having said that, it may end up being the right decision for North Dakota.

First, North Dakota does not rely on the individual income tax to the extent that some states do. In fiscal year 2019, the individual income tax only generated 6.2 percent of the state's total tax collection.[1] Second, the top marginal rate is already low enough that eventual repeal is within sight. The potential challenge is budget sustainability.

The wrong timing or wrong combination of revenue reductions or spending restrictions could make service delivery especially challenging. North Dakota policymakers have wisely avoided inadvertently fashioning unfunded liabilities with past reforms by making incremental changes and assessing the sustainability of future reforms each biennium. The current proposal comes at a time when many economists suggest that a recession is still possible sometime in 2023, which could pose a concern for many states' budgets. While that is not a concern to be dismissed out of hand, we find that to be less

[1] https://taxfoundation.org/publications/facts-and-figures Facts and Figures, Table 7.

threatening in this case as the state is in a healthy financial position with over $3.5 billion in savings and surplus expected by the end of the current budget biennium.[2]

The primary advantage of HB 1425 is the incorporation of revenue triggers, which are helpful in setting conditions for responsible rate reductions in the future. Historically, the North Dakota legislature has been hesitant to bind future legislatures to predetermined tax changes, preferring instead to implement reforms in two-year increments. But revenue triggers need not pressure future governments. Well-designed triggers limit the volatility and unpredictability associated with changes to the tax code.

An ideal tax trigger would establish a revenue benchmark that allows the General Fund to grow commensurate with inflation and population growth. If revenue collections exceed the benchmark, then the rate would be automatically reduced in proportion to the surplus. It may be tempting to establish a benchmark using the official revenue estimate rather than actual prior-year revenues, but this approach is risky. If a revenue estimate is mistaken, or if the baseline is lower than usual due to an economic downturn, then the state may inadvertently find itself with unfunded liabilities due to premature tax cuts.

If the intent of the legislature is to craft a bill that addresses individual income tax cuts in the longer-term, we highly recommend incorporating a well-designed revenue trigger into a bill that levies a flat rate on a broad base. A well-designed revenue trigger would responsibly reduce rates in the future and could be the ideal way forward for the legislature.

Thank you again for the opportunity to testify before you today. I'm happy to answer any questions the committee may have.

[2] https://www.kxnet.com/news/state-news/north-dakotas-68th-legislative-assembly-kicks-off/