Common Cents

New Hampshire Fiscal Policy Institute Blog

Tax Policy: Criteria for an Effective Trigger Mechanism

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In recent days, some have suggested that one potential path to compromise on proposed reductions in the rates of the business profits tax (BPT) and business enterprise tax (BET) would be to make such changes subject to a "trigger" mechanism of some kind – that is, to make the changes contingent upon the attainment of certain criteria. Lowering the rate of the BPT from 8.5 to 7.9 percent and the rate of the BET from 0.75 to 0.675 percent, as the version of the FY 2016-2017 budget approved by the legislature in June would do, would not only impair New Hampshire's ability to make investments in education, infrastructure, and other public services essential to widely shared economic prosperity but also deliver the bulk of their benefits to a relatively select set of very large corporations.

Should policymakers elect to adopt such rate reductions and to pair them with a trigger mechanism, they should strive to structure that mechanism so that it protects, to the maximum extent possible, New Hampshire's long-term fiscal outlook and so that it ensures any rate reductions achieve their purported policy goals. In particular, any trigger mechanism should:

Recognize that New Hampshire's business taxes have yet to recover fully from the national recession. Based on preliminary data from the Department of Administrative Services, combined BPT and BET revenue fell, after adjusting for inflation, by more than $120 million between FY 2008 and FY 2015. Economic factors may have contributed to this decline, but previous changes in tax policy have certainly had an impact as well. This decline, in turn, creates enormous fiscal strains and leaves New Hampshire unable to adequately support mental health services, higher education, or local communities. A sound trigger mechanism would ensure that no rate reductions occur until a complete recovery has taken hold and combined BPT and BET revenue has returned to its prior peak, after accounting for inflation.

Make rate reductions contingent upon real and sustained revenue growth. Proponents of rate reductions frequently assert that future revenue growth will compensate for the revenue loss associated with reductions in the rates of the BPT and

BET. Accordingly, a sound trigger mechanism would require that business tax revenue grow at a rate sufficient to keep such revenue from declining, once rate reductions have been implemented and after adjusting for inflation. (The program costs that state revenues are intended to meet grow from one year to the next; a responsible trigger mechanism would thus account for inflation.) In addition, the trigger mechanism should require that such growth be sustained for multiple years before permitting future rate reductions to occur, so that rates do not fall in response to a temporary uptick in collections.

Ensure specific economic growth targets are met. Proponents of changes to New Hampshire's business tax system have also repeatedly argued that such changes are necessary to make New Hampshire more competitive and that they will lead to more robust economic growth. Consequently, a meaningful trigger mechanism would, in addition to establishing the fiscal criteria described here, require that the Granite State economy meets certain benchmarks (for instance, employment, wage, and personal income growth in excess of national and regional levels) before future rate reductions are instituted.

Allow New Hampshire to replenish its budgetary reserves and maintain them over time. At the close of FY 2014, New Hampshire's Stabilization Fund, also known as the rainy day fund, held a total of \$9.3 million in reserves. According to documents produced by the Legislative Budget Analyst's Office, the version of the FY 2016-2017 budget approved by the legislature was expected to bring that sum to \$23.8 million by the end of FY 2015, though that number may change as the state closes its books on FY15. In either case, those reserves remain considerably below the levels recommended by public finance experts and leave New Hampshire vulnerable to future economic downturns. As reductions in the rates of the BPT and BET would necessarily diminish the size of any future surpluses and therefore curtail New Hampshire's capacity to build up reserves, a sound trigger mechanism would make future rate reductions contingent upon reaching an adequate balance in the Stabilization Fund.

Not amount to closing the barn door after the cows have left. In 2011, New Hampshire enacted a reduction in its tobacco tax, dropping the tax rate on cigarettes from \$1.78 to \$1.68 per pack. While that reduction was accompanied by a trigger mechanism, that trigger was not pulled until after the state had lost considerable revenue. Policymakers should learn from that experience and structure any business tax trigger mechanism so that it is prospective rather than retrospective.

Prevent future rate reductions from occurring during, and therefore exacerbating the effects of, future recessions. While the above criteria, taken in combination, may provide a safeguard against such an outcome, policymakers may wish to structure the trigger mechanism so that it delays future rate reductions if total General and Education Fund revenue is expected to decline in a given year.

Failure to incorporate the preceding elements would reduce the effectiveness of any trigger mechanism and likely increase the adverse fiscal and economic consequences of business tax rate reductions.

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