



BULLETIN

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Summary of Proceedings 1995 Annual FTA Revenue Estimation and Tax Research Conference

To State Tax Administrators:

SUMMARY

The 50th annual FTA Revenue Estimating and Tax Research Conference was held October 22-25, 1995 in Lexington, Kentucky. Presiding over the conference was Deborah Bierbaum, New York Department of Taxation and Finance and Chair of the FTA Research Section. This bulletin summarizes the proceedings and lists the various papers available from FTA.

The 50th annual FTA Revenue Estimating and Tax Research Conference was held October 22-25, 1995 in Lexington, Kentucky. Presiding over the conference was Deborah Bierbaum, New York Department of Taxation and Finance and Chair of the FTA Research Section. Welcoming the participants was Kim Burse, Secretary of the Kentucky Revenue Cabinet.

The program included presentations by the major forecasting firms and industry representatives discussing their economic forecast for the next 18-months. Presentations were made on the impact of Federal tax reform on state taxation, and participants heard a discussion about the Internet and its potential uses. The entire day of Tuesday was dedicated to various concurrent sessions covering issues of interest to state economists. Some of the topics included natural resource taxation, estimating the revenue effects of gambling activities, federal tax reform, taxation of new technologies, improving the quality of revenue estimates, managing a research department, revenue forecasting methodology, and revenue departments on the 'Net.

On Wednesday morning, the participants heard several miscellaneous presentations on topics of broad interest to state economists. A representative of the Kentucky Tax Reform Commission discussed the preliminary results of their study on tax reform. An analysis of Limited Liability Companies (LLCs) and other flow-through entities was also presented. And finally, representatives from the Internal Revenue Service and the Congressional Budget Office discussed several projects of interest to state researchers.

Economic Forecasts

The conference began with several presentations on the economic outlook by the major forecasting companies. They included the overall macro economic outlook, regional outlook, and various industry sector forecasts.

Cynthia Latta, a Senior Financial Economist with DRI/McGraw-Hill, discussed how the Federal Reserve successfully engineered a soft-landing. About two years ago, the Fed began slowing monetary policy by raising interest rates. Seeing a sharp increase in the factory operating

rates and a drop in the unemployment rate, the Fed interpreted these changes as potentially leading to an increase in labor cost and future inflation. By raising the interest rates early, they were able to slow the rate of economic growth to diminish these inflationary pressures.

Ms. Latta noted how the U.S. is in a good position for steady growth, forecasting a real rate of increase in GDP of 2.5 percent. Much of this can be attributed to a good international situation. She showed how U.S. labor is a bargain among the industrial nations, with a high level of productivity and low relative costs. However, she also pointed to several factors that could adversely affect her forecast. The overall level of consumer debt has been rising, which could lead to a drop in consumer purchases. However, the cost of carrying this debt has also dropped. In addition, there is some potential for some of our low-wage jobs being lost to some of the rapidly developing countries. Over the long-term, Latta pointed to problems associated with an aging population and changing income distributions as factors that could affect her forecast.

Mark Zandi, Chief Economist for the Regional Financial Associates, discussed several factors accounting for the different economic conditions in the various regions. Agreeing with the DRI forecast, Zandi noted that a 2.5 percent national growth rate means certain regions will not be doing very well. He expects the current patterns to continue, with fast growth in the South and West while the Northeast and California continue to see slow rates of growth. However, he expects the differences in the growth rates to diminish in the future.

Zandi identified four areas affecting economic growth. They include globalization of businesses, deregulation, rapid pace of technological change, and an aging population. Each of these are expected to put greater pressure on businesses to become more efficient and reduce operating cost. Thus, he notes how regions with lower relative costs of operating will see the greatest level of growth.

Stanley Duobinis discussed the outlook for the housing industry. The National Association of Home Builders economist began his presentation by highlighting the factors influencing home purchases. Key among these is employment and income growth. Interest rates are still an important factor, but its impact has been diminished by the creation of Adjustable Rate Mortgages (ARM). With a slow but steady rate of economic growth forecasted and Fed policy remaining unchanged, Duobinis expects a consistent steady rate of growth in new housing starts during 1996. However, a large inventory of housing stocks from earlier this year will cause some slowdown in new housing starts during the remainder of 1995.

The outlook for consumer durables was given by Evan Barrington, with the Stevenson Group. He began by pointing out how many businesses are undergoing reorganization and out-sourcing some of the work they currently do in-house. This downsizing will have a direct impact on purchases of durable goods. Much of the sales of housing-related durables is driven by new home sales, with existing house sales and remodeling providing a minor source for demand only. Sales fell in early 1995 due to the slowdown in new housing starts and some factors pushing sales into 1994. Barrington expects sales of household durables to finish the year down about 2 percent. He expects next year will see no significant growth in the shipments of durable goods, except for consumer electronics.

Mark Haas, Michigan Treasury Department, discussed the outlook for automobile sales. Basing his forecast on an economic outlook of a steady growth trend, Haas then turned his discussion to the factors influencing automobile purchases. He identified eight factors, including consumer buying attitudes, current vehicle age, disposable income, job security, vehicle prices/affordability, financing costs, fuel prices and fuel efficiency. Also, the industry has changed dramatically during the past decade, with domestically produced foreign autos now accounting for a greater share of total production. In addition, small truck and sport vehicles are a growing share of total sales, and leasing is becoming more prevalent. Overall, sales will remain

strong during the next several years, with sales just under 15 million units each year. The changing trends in vehicle mix will continue and excess production capacity with domestic producers will remain a problem.

Steve Brown, from the Federal Reserve Bank of Dallas, presented the outlook for the energy industry. He focused his talk on past, present and future trends in the energy industry. Brown noted that during the 1970s, changes in the supply of energy (mostly oil) had a widely varying effect on the different states. Energy-producing states saw an increase in economic growth when oil prices rose, while energy-using states saw a sharp decrease. Recently however, many of these states have diversified their industrial mix. He illustrated this trend through an index of *Oil Price Sensitivity*. He expects this trend to continue into the future with states becoming less sensitive to shocks in the energy industry.

Keynote Luncheon Speaker

In keeping with the theme for the 50th Annual Revenue Estimating Conference, John Shannon gave a keynote address to the conference titled, *50 Years of Revenue Estimating & Tax Policy Analysis*. As a Senior Fellow with the Urban Institute, Mr. Shannon began his career in tax policy with the Kentucky Revenue Cabinet as a revenue forecaster. He recalled some of his experiences attending his first FTA Revenue Estimation Conference during the 1950s. In doing so, he noted several changes in the way revenue estimates are done, as Kentucky moved the forecasting functions from the Revenue Cabinet to the Finance and Administration Cabinet.

Mr. Shannon then turned his remarks to some of his recent work analyzing fiscal federalism. He admitted to a radical change in thinking recently, noting how there is some good in intergovernmental competition. While much of the competition among states leads to more and more tax breaks to specific businesses encouraging them to locate in their state, he described another aspect of intergovernmental competition. Some competition works to improve the efficiency of state tax systems. It acts to encourage state officials to improve conformity with other states, keeping state tax systems from becoming too radically different from others. This competition even works on the expenditure side and balancing the federal/state relationship. Indeed, Shannon attributes a growth in state and local activities to the increasing mistrust of the federal government. Today, state and local governments collect almost the same amount of revenue as the federal government.

Monday Afternoon General Session

The afternoon session was dedicated to two key topics of interest to all state participants. Dan Bucks, Executive Director of the Multistate Tax Commission, spoke on the federal tax reform proposals and the implications for the states. He noted how the proponents of the different proposals currently being debated in Washington have not even considered the impact to state tax systems. In some cases, the states' ability to levy their current income tax would be eliminated, and others would severely limit states' tax policy choices. He suggests that state tax officials need to act now to begin gearing up research efforts. They need to educate federal officials on the state impacts of their tax reform proposals. And finally, Bucks reminded state officials not to be blind to change but open to opportunities for improvements in the total tax system. Federal tax reform can help states improve their own tax structure and fix some of the problems in the current system.

Bucks then turned his attention to the major proposals currently being debated in Washington, and summarized their impact on state tax systems. The Lugar National Sales Tax and Euro-style VAT taxes would repeal state income taxes. The federal analysis thus far, has ignored the need to replace state income tax revenues, which has the effect of raising the effective tax rate to consumers. He also pointed out issues of who will control the tax base under a shared administrative system. The Nunn-Domenici plan, while enabling states to maintain an income tax, poses some problems with interstate mobility. The Operational VAT business tax in the Nunn-Domenici and the Arney-Specter plan are federalism friendly, permitting states to piggy-back on

the federal business tax and maintain some control over tax policy. It even provides a potential for minimizing the international transfer pricing problem. The Arney-Specter individual flat tax diminishes the flexibility of states to define the tax base. Meanwhile, the Gephardt plan would have a similar impact as the 1986 tax reform act. However, there would be some tax exempt financing and state-local tax deductibility issues.

With the rapid growth in the use of the Internet, Stanley Chervin, with the Tennessee Department of Revenue, gave a brief overview of the Internet. He began by pointing out how the rapid pace of technological change is having a big impact on users of the Internet. Indeed, he noted how much of his presentation may not be valid in several months. In describing the Internet, he made an analogy of a single large computer where everyone can connect, have an e-mail account, retrieve files, view data, and search for unique data. While the Internet may appear this way to most users, it is actually more than six million computers linked together by high-speed data connections.

The recent trend has been the development of software which makes it easier to navigate and find information on the Internet. This software has made using the Internet so easy, it actually acts like one large computer. To illustrate, Chervin discussed four examples of how to find information. He described how you would find information when you know where to go. A second example described how you would find information you know is on the 'Net but do not know its location. And finally, he described how to browse by a particular subject or by type of information.

Wednesday Morning General Session

The Wednesday morning general session dealt with several issues of interest to state tax researchers. Bill Lear, co-chairman of the Kentucky Commission on Tax Policy, discussed the activities of his commission. He described the current Kentucky tax structure as a complex web of different laws that were built over time with no comprehensive thought. Many of the tax provisions were enacted during earlier times when the state's economy was more oriented towards manufacturing industries, with different demographics and no welfare system. He concluded with five recommendations for other states undertaking a similar analysis. They should get good technical support, organize and complete the study during the same political cycle (when the same governor is in office), do not cut taxes before the commission starts, keep the private sector involved, and keep the information flowing to all parties in simple easy-to-understand terms.

With the creation of new flow-through entities, many conference participants were interested in knowing how these new business types would impact existing revenues. Patrice Cohen, a principal econometrician with the New York Department of Taxation and Finance, discussed her experiences examining Limited Liability Companies (LLC) and Limited Liability Partnerships (LLP). While each has different rules and requirements in the different states, Cohen pointed out three goals of these new business entities. They include limiting the liability of partners or owners, more flexibility than S Corporations, and more options (less restrictions) on owners. Currently, 26 states allow some form of LLC/LLP.

To understand the impact of the New York State LLC/LLP legislation, the state economists built a model of corporate and partnership businesses. They assumed that any business would convert if the 3-year tax savings exceeded the conversion cost. In total, they forecasted 8,300 partnerships and 175 C Corporations would convert during the first year. They did not expect any S Corporations to convert.

Rick Fratanduono gave the participants an update on the activities of the IRS District Office Research and Analysis (DORA) groups. The chief DORA coordinator discussed the purpose of creating 30 DORA offices throughout the country. It enables the Service to implement the new market and geography segmentation compliance program by putting the compliance researcher

much closer to the people in the field. This allows them to plan for implementation while testing and refining new compliance methods. He pointed out some recent accomplishments, including an automobile retail project in California, using information from mortgage banks to confirm income, and other projects. The data and analysis currently underway in local DORA sites will be used for compliance projects in 1997. Mr. Fratanduono welcomed the assistance of any states that would like to work with the IRS compliance researchers and handed out a brochure listing the different DORA sites and phone numbers.

Antonio Santalucia discussed the Congressional Budget Office's (CBO) role in analyzing and estimating the impact of Federal mandates. The *Unfunded Mandates Reform Act of 1995* (PL 104-4) requires the CBO to estimate the direct costs of any mandate exceeding \$50 million for intergovernmental and \$100 million for private sector. The new rules apply to new mandates, a reduction in appropriations for existing mandates, and restrictions or limitations to states' taxing powers. The only enforcement powers granted under the Act is a point-of-order requirement for any bill reported out of a committee without a CBO estimate. This could be overridden by a simple majority vote to waive this requirement. He discussed two recent analyses completed by CBO. One dealt with restricting states' rights to tax ticket sales (in the Amtrak Reauthorization Bill). A second provided an exemption from state and local sales and use taxes for contractors working on NOAA contracts. Santalucia concluded by discussing their efforts at creating a contact list of state experts that could assist CBO on short notice. He suggested that any conference participant interested in helping CBO can call Terri Gullo at 202/225-3220.

Breakout Sessions

On Tuesday, conference participants were offered several concurrent breakout sessions. Sessions offered included implications of Federal tax reform on state taxation, estimating the effects of gambling activities, natural resource taxation, taxation of new technologies, several revenue estimating/forecasting sessions, managing a research department, and revenue departments on the Internet. A special training track session on how to make formal presentations was also offered.

Papers Available

General Session—Monday

- Cynthia Latta, DRI/McGraw-Hill, *General Macro Economic Outlook* (tables accompanying remarks).
- Mark Zandi, Regional Financial Associates, *Economic Outlook—Regional Perspective* (tables accompanying remarks).
- Stanley Duobinis, National Association of Home Builders, *Outlook for Housing* (tables accompanying remarks).
- Evan Barrington, Stevenson Group, *Outlook for Consumer Durable Goods* (tables accompanying remarks).
- Mark Haas, Michigan Department of Treasury, *Outlook for the Automobile Market* (tables accompanying remarks).
- Stephen Brown, Federal Reserve Bank of Dallas, *The Energy Industry: Past, Present and Future*, printed in *The Southwest Economy*, Issue 4, 1995.
- John Shannon, Urban Institute, *50 Years of Revenue Estimating & Tax Policy Analysis* (background material to accompany remarks on intergovernmental trends).
- Dan Bucks, Multistate Tax Commission, *Federal Tax Restructuring* (slides used in presentation).
- Stanley Chervin, Tennessee Department of Revenue, *Internet—An Introduction*.

General Session—Wednesday

- Patrice Cohen, New York State Department of Taxation and Finance, *Limited Liability Companies and Other Flow-Through Entities: Trends and Experiences, New York State*.
 Antonio Santalucia, Congressional Budget Office, *The Unfunded Mandates Reform Act of 1995* (outline of remarks).
 Richard Fratanduono, Internal Revenue Service, *Update on the IRS Compliance Research Activities* (slides used in presentation).
 Richard Fratanduono, Internal Revenue Service, *The Mission Statement—DORA* (brochure summarizing the locations and phone numbers for local DORA offices).

Breakout Session II. Implications of Federal Tax Reform on State Taxation

- Tom Neubig, Ernst and Young, *Major U.S. Tax Reform Proposals and Key Issues for State and Local Governments* (slides used in presentation).
 Robert Cline (and Paul Wilson), Minnesota Department of Revenue, *Consumption Tax Incidence: A State Perspective* (preliminary report).

Breakout Session III. Estimating the Revenue Effects of Gambling Activities

- Gregory Albrecht, *The Current Status and Estimates of the Net Economic Impact of the New Gaming Activities in Louisiana*.
 Gregory Albrecht, *What States Have What Gaming and Gaming Revenue by Industry* (tables accompanying remarks).
 David Griffiths, *Interaction Between Lottery and Video Gaming in Oregon* (tables accompanying remarks).
 Bob Rogers, *Riverboat and Casino Gambling in Iowa*.
 Richard Thalheimer, *Interaction Between Horseracing and Video Gaming in Kentucky*.
 Darrin Webb, *Casino Gaming in Mississippi* (outline and tables accompanying remarks).

Breakout Session IV. Issues in Natural Resource Taxation

- Earl Goldhammer, American Electric Power Service Corporation, *State Taxation of Electric Companies in a Deregulated Environment*.
 James Alex, KPMG Peat Marwick, *Analysis of Coal Consumption Tax Credits Under 15 USC §391 and Other Thoughts* (outline of remarks).
 Mark Muchow, West Virginia Department of Tax and Revenue, *Analysis of an Emission Allowance Subsidy Program to Promote High-Sulfur Coal Production*.
 Perry Bissell, CONSOL Inc., *Coal: A U.S. Growth Industry*.
 Arley Williams (and Tom Clifford), *Methodology to Evaluate a Tax Incentive for Work Over and Recompletion Projects for Crude Oil and Natural Gas Wells*.

Breakout Session V. Taxation of New Technologies

- Clarence Brasfield, BellSouth Corporation, *Implications of the Federal Telecommunications Reform: Thoughts for the States*.
 Clarence Brasfield, BellSouth Corporation, *Unit Valuation for Telecommunications Property: Four Decades and a Funeral*, reprinted from *State Tax Notes*, August 14, 1995.
 Ron Mucha, Ohio Department of Taxation, *Telecommunications Taxation and Economic Development in Ohio* (tables accompanying remarks).

Breakout Session VI. Methods to Improve the Quality of Revenue Estimation

- Bob Megna (presented by Patrice Cohen), New York State Department of Taxation and Finance (summary of available data).

Breakout Session VII. Managing a Research Department

- Scott Jordan, Massachusetts Department of Revenue, *Spinning Off Innovations from a Research Unit* (outline of remarks).
 Joe Fitz, California Board of Equalization, *A Look at the Deterrence Effects of Audits*.

Breakout Session VIII. Methodology and Issues in Revenue Forecasting

Connie Squires, California Department of Finance (selected papers and tables accompanying remarks):

Peter Berck, University of California, *A Work Plan for a Dynamic Computable General Equilibrium Model of California*, August 1995.

Peter Berck and Andrew Dabalen, University of California, *A CGE Model for California Tax Policy Analysis, A Review of Literature*, Summer 1995.

Laird Graeser, New Mexico Taxation and Revenue Department, *Revenue Estimating—Science or Madness?*

Michael Hyman, New York City Department of Finance, *Methodology and Issues in Revenue Forecasting* (tables accompanying remarks).

Breakout Session IX. Revenue/Taxation Departments on the 'NET

Tom Williams, Utah State Tax Commission, *Utah State Tax Commission—Public Access Information Sources* (printout of selected Web pages).

Michael Wegner, Texas Comptroller's Office, *Bringing Government On-Line* (summary of Texas's on-line resources), published in *Fiscal Notes*, Special Section, June 1995.

Gorden Schuford, South Carolina Department of Revenue (printout of selected Web pages).

Stanley Chervin, Tennessee Department of Revenue, *Revenue/Taxation Departments on the 'Net* (summary of state revenue agency Web pages).

Ronald Alt, Federation of Tax Administrators (printout of selected Web pages).

Other Papers Distributed at the Conference

Arizona Department of Revenue, *Overview of 1995 Economic Development Policy Legislation*.

