FY-2004

Executive Budget

Governor Brad Henry

February 3, 2003

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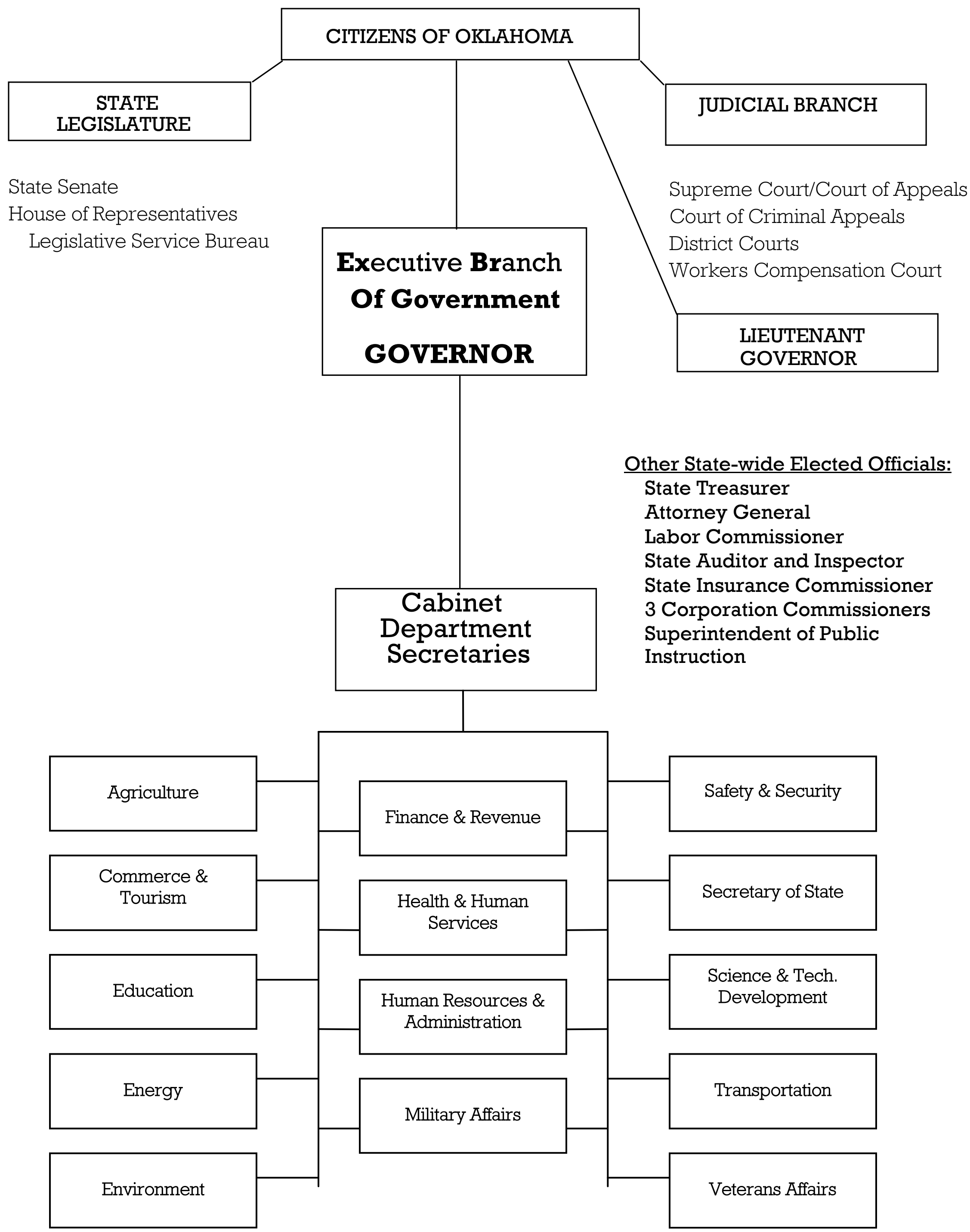

The Cabinet Secretaries are appointed by the Governor with the approval of the Senate. Many of the secretaries are also heads of Executive Branch agencies. Most state agencies have a controlling board or commission which appoints a chief operating officer. Most board and commission members are appointed by the Governor, some requiring Senate approval. Some agencies do not have a controlling board, and most of those agency heads are appointed by the Governor with Senate approval. More information on the appointment process is included in the Executive-Historical document. State agencies are assigned to a cabinet department by the Governor. The specific agency assignments to each cabinet are shown on the next page.

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* Agency is headed by a statewide elected official or their controlling board is made up of elected officials. They are assigned to a cabinet department for purposes of coordinating services and programs only.

Rising To The Challenges Before Us

"Oklahomans have accomplished much in very little time," U.S Tenth Circuit Court of Appeals Judge Robert Henry wrote in the forward to *Oklahoma Politics and Policies* (University of Nebraska Press, 1993). "Tempered by hardship and accustomed to hard work, we Oklahomans have gone about as far as hard work alone can take us. It is time to transcend the politics of negativism, of preservation of a dismal status quo, of a populism that preaches, 'If I can't have it, I don't want anybody else to,'…."

The truth of those words resounds today, perhaps even more than when they were first penned ten years ago. Oklahoma faces one of its greatest challenges in recent memory. Some would contend that the very core of state government is at risk. It would be easy to hide, to shirk from the responsibility before us and to agree with the doomsayers. This budget does not do that.

Instead, this budget views the current situation as a challenge but not an unconquerable one. Oklahomans are well aware that the amount of money available for appropriation during this legislative session is substantially less than that available during the last session. This difficult situation presents us with some unique opportunities. To some, however, the opportunities do not exist. They are wrong. There are many opportunities available to us that must be seized. This budget reflects the work of many and long hours of hard work.

My budget protects funding for the most vital areas of state government. We cannot balance the budget on the backs of Oklahoma school children and their teachers, the sick, elderly and the disabled. Oklahoma values its children and their future, its seniors and those less fortunate. To that end, this budget avoids major reductions in education spending and healthcare spending.

We must invest in education. Our future depends on it. However, we must ensure our investment gets to the classroom. This budget increases our investment in education by nearly $110 million while reducing administrative overhead. Our budget makes education a priority, and the investment in education should be funded early in the legislative session.

Budget cuts in education could be devastating to our efforts to move our state forward. Reductions in healthcare spending could result in aged, blind and disabled patients losing essential services they require; elderly clients losing nursing home care; and the reduction of healthcare services for thousands of Oklahomans.

Nevertheless, there are cuts that must be implemented. My office is reducing its spending. I am asking other state agencies to reduce their spending as well. The cuts outlined in this budget target specific areas. Cuts in government spending, by definition, mean someone is affected: someone who receives a service, someone whose employment is tied to that money or a community which benefits from a state-funded project. These spending reductions, however, are designed to improve the efficiency and effectiveness of government, minimizing the impact on vital government services.

The public has entrusted us to be prudent managers of their money. It is imperative that we uphold that trust. The spending proposals outlined in this budget reflect priorities important to Oklahoma now and in the future. The same is true of the proposed spending reductions and improvements in the effectiveness and efficiency of state government.

Challenging times like these require unique responses. This budget contains several. This budget examines several revenue changes that will improve compliance, equity and efficiency while avoiding tax increases. We propose capitalizing on historically low interest rates as well as finding ways of leveraging federal funds. Additionally, each agency's resources were scrutinized and proposals put forth to consolidate programs to eliminate duplication. There has never been a more important time to consider proposals such as these.

Oklahoma must examine itself. It must set priorities, recognizing that the status quo cannot and should not be preserved. I call on all Oklahomans to put aside their partisanship and special interests. Together, we will emerge from these trying times stronger than ever before.

By adopting the agenda I have set forth in this budget, we can overcome the obstacles before us. It will not be easy, but time-and-time again Oklahomans have proven that one of our greatest strengths lies in our ability to do just that. We will provide vital state services effectively and efficiently. We must protect funding for our most important state services and implement new, bold ideas. In other words, we will preserve and expand Oklahoma's greatness.

Revenue Performance from FY-2002 to FY-2004

As a result of the national recession Oklahoma is experiencing many of the same problems observed in other states. Revenue collections began lethargically in FY-2002 and significant problems were evident midway through the year. In December 2001, the Office of State Finance (OSF) implemented budget cuts in the General Revenue fund and several other funds due to extremely poor performance of the gas and oil gross production taxes.

Early in FY-2002 most other General Revenue fund collections were performing well and mitigated some of the problems in gross production taxes. However, as the year evolved, performance of these revenues deteriorated and further budget cuts were required to prevent deficit spending. Final General Revenue collections for FY-2002 were $415 million or 8.6% under the estimate.

Since appropriations are capped at 95% of the official estimate, budget cuts from this fund were only $174 million or 3.8%. Although the two major sources or revenue, Individual Income tax and Sales tax, were under the estimate, the budget cuts were due solely to the steep decline in receipts from the Gross Production tax on natural gas.

The individual income tax rate reduction passed in 1998 contained a "trigger" provision which results in a temporary tax increase if revenue estimates certified by the State Board of Equalization decline from one year to the next. In December 2001, this trigger was implemented and the top marginal rate on individual income tax increased from 6.75% to 7% for calendar year 2002, increasing the certified estimate for FY-2003.

The 2002 legislature enacted further budget reductions for FY-2003 since appropriations authority was $350 million or 6.2% lower than the amount originally appropriated in FY- 2002. The legislature began with across-the-board cuts of 5% for most agencies. Certain critical programs, such as education, Medicaid, social services, and mental health, were exempted or received no budget cuts. Also, the legislature appropriated $268 million from the Constitutional Reserve Fund and enacted revenue enhancements of $55 million.

Revenue collections for the first half of FY-2003 have been very weak. After analyzing final receipts for the month of August, it was apparent that collections would not improve enough by the end of the fiscal year to maintain current spending levels. Accordingly, in early September the Office of State Finance implemented budget cuts of $213 million or 4.75% on an annual basis, in anticipation of a total revenue shortfall of 9.6%. An additional shortfall was expected in the 1017 Education Reform fund of $47 million or 10.1%.

General Revenue Fund Performance, FY-2003 July to December

Source	Collections July to December ($ Millions)	Variance from Estimate (%)	Variance from Prior Year (%)
Net Income Tax	$923.40	-15.20%	-7.90%
Gross Production Tax	128.30	-1.60%	7.10%
Sales Tax	602.00	-9.60%	-4.70%
Motor Vehicle Tax	104.70	-14.20%	-7.30%
Subtotal	$1,758.40	-12.40%	-5.80%
Other Sources	248.80	-8.50%	-15.30%
Total	$2,007.20	-11.90%	-7.10%

Two more months of collections data revealed further weakening in most revenue sources. In November the Office of State Finance deepened the budget cuts to 6.5% on an annual basis. OSF delayed implementation of these additional cuts until December in order to give agencies time to plan and prepare for the additional cutbacks. The shortfall in the 1017 Education Reform fund increased to $59 million or 12.9%.

Unlike FY-2002, performance in Individual Income, Corporate Income, Sales, and Motor Vehicle taxes are all very weak while the Gross Production tax is beginning to have a positive influence. There continues to be much uncertainty about the economy, the stock market and the possibility of war, all of which add to the uncertainty of revenue recovery for this fiscal year.

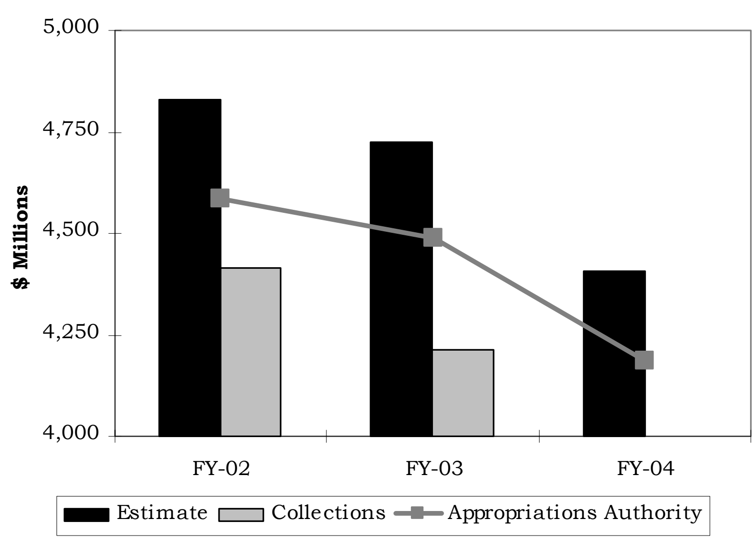
This sets the stage for estimating the amount of revenue available in FY-2004. The prevailing thinking at this time is that the national and Oklahoma economies will begin a relatively slow recovery from the current recession sometime in 2003.

The perceived slowly recovering economy enabled the Board of Equalization to certify a revenue estimate for the General Revenue fund above the projected amount of collections for FY-2003 by $195 million. The table below details this modest growth in general revenues.

FY-2003 Projection vs. FY-2004 Estimate

Four Major Taxes	Difference $ Millions	Difference %
Sales Tax	$31.1	2.6%
Motor Vehicle Taxes	19.7	9.3%
Income Taxes	130.3	6.5%
Gross Production Tax	(3.3)	-1.3%
Subtotal	$177.8	4.8%
Other	17.3	3.3%
Total	$195.1	4.6%

Comparison of General Revenue Estimate, Collections, and Appropriations Authority, FY-2002 through FY-2004



Source: DRI-WEFA and Oklahoma State University

However, this represents total revenue. As the chart below indicates, after accounting for the 5% of estimated revenue that cannot be appropriated, the FY-2004 General Revenue available for appropriation is $25 million less than projected FY-2003 General Revenue fund collections.

Examination of the total budgetary context reveals an even worse situation. The budget is based on appropriations authority, which includes:

- certified funds,
- 1017 fund,
- certain other funds,
- cash; and
- the rainy day fund.

Total appropriations authority for FY-2004 is $593 million dollars less than FY-2003. State government is currently operating on a greatly reduced budget due to the revenue shortfall of FY-2003 and the resulting 6.5% across the board budget cuts.

The table below compares FY-2004 total appropriations authority to the current budget for FY-2003. This comparison shows there is $242 million less in appropriations authority. As the table highlights, the majority of this decrease is due to the heavy reliance upon the Rainy Day fund last year.

Comparison of FY-2003 Current Budget and FY-2004 Total Appropriations Authority ($ Millions)

Source	FY-2003 Current Budget	FY-2004 Total Appropriations Authority	Difference $
Certified Funds	$4,421.3	$4,418.9	($2.4)
1017 Fund	401.9	380.5	(21.3)
Gross Production Education Funds	67.0	79.6	12.6
Tobacco Fund	33.1	30.9	(2.2)
Cash	57.6	25.6	(32.0)
Subtotal	$4,980.8	$4,935.4	($45.4)
Rainy Day Fund	268.5	72.4	(196.1)
Total	$5,249.4	$5.007.8	($241.6)

The Board of Equalization determined in December that revenues for the coming legislative session again would not exceed those certified for the prior year. As a result, the "trigger" provision will remain in effect and the top marginal individual income tax rate will remain at 7% for tax year 2003.

Tax Changes

Oklahoma faces numerous challenges to get through the difficult fiscal situation we are experiencing this year and next. This budget has addressed these challenges without general tax increases. Instead, it contains proposals for revenue changes that will result in improvements in compliance, efficiency and equity.

Cigarette Tax
Oklahoma's cigarette tax is 23 cents per pack. Cigarette wholesalers pay the tax by purchasing a stamp that they must affix to each pack distributed. Wholesalers receive a 4% discount off of the price of the stamps bought. Once a stamp is placed on each pack, wholesalers sell the cigarettes to the retailer. At the retail level, the consumer pays state and local sales taxes placed on cigarette purchases.

The State has cigarette compacts with all but 2 Indian tribes in Oklahoma. Under the compacts, the cigarette tax is 25% of the state rate, only 5.75 cents per pack. The tax is still paid in the form of a stamp which must be placed on each pack. Wholesalers also receive a 4% discount on total tribal stamps bought. However, the compacts exempt tribal retailers from collecting a sales tax on cigarette sales.

Collecting taxes at the wholesale level is more efficient than at the retail level. There are only 126 wholesale distributors and tax compliance is virtually guaranteed since distributors must be bonded. This is in contrast to the numerous retailers that sell cigarettes, where there is not that same high probability of compliance.

This proposal removes the state share of sales tax from the retail purchase and replaces it with an increase of 12.4 cents in the cigarette tax. This will bring the total cigarette tax to 35.4 cents per pack. The levy of local sales tax will remain in place. Since the tribal compacts specify that cigarette tax is levied at 25% of the state rate, the cigarette tax for tribal sales will increase to 8.9 cents per pack.

Fiscal Impact Summary of Proposed Cigarette Tax Changes

	FY-2004 ($ in 000's)			
Proposal:	**General Revenue Fund**	**Ed. Reform Rev. Fund**	**Teacher Retire. Fund**	**Total Impact to Collections**
Eliminate Sales Tax on Cigarettes	($23,289)	($2,821)	($958)	($27,068)
Additional Revenue from Tribal	4,900	-	-	4,900
Gain from Compliance	422	51	17	491
Increase in Cigarette Tax	27,068	-	-	27,068
Subtotal of Cigarette Tax Switch Plan	**$9,101**	**($2,769)**	**($941)**	**$5,391**
Reduction in Discount Rate	1,897	-	-	1,897
Net Impact to Funds for FY-2004	**$10,998**	**($2,769)**	**($941)**	**$7,288**

This proposal also includes a decrease in the discount rate from 4% to 2% which is more in line with discounts granted in surrounding states. Both components of this proposal will increase the General Revenue Fund by $11.0 million.

The above table details the fiscal impact of this proposal.

Federal Refund Offset

Legislation passed in 2001 authorized a pilot program for Oklahoma to participate in the federal refund offset program. Under this program, the State can use federal refunds or overpayments to satisfy delinquent state individual income tax liability. Under this proposal, the IRS provides the Tax Commission with a list of delinquent state taxpayers receiving federal refunds. The Tax Commission notifies the taxpayer who has 60 days to pay the delinquent tax liability. If it is not paid, the IRS will send the refund to the State to reduce the taxpayer's liability. In FY-2002, the State collected an additional $3.4 million in individual income tax under this program.

For FY-2003, additional collections are projected at $2.3 million given the Tax Commission's resources for participating in the pilot program. Additional authorization is required to expand this program beyond the initial pilot phase. This budget proposes such authorization. The associated increase in revenues is an estimate of $4.5 million for FY-2004. Ultimately, additional revenue is expected to decrease as delinquent accounts are paid and taxpayers are brought into compliance.

Sales Tax

Under current law, if a business' sales tax liability is more than $25,000 a month, the vendor is required to remit sales tax collections electronically. For taxes collected on sales from the 1st through the 15th of the month, the sales tax payment must be remitted on the 20th of that same month. For taxes collected during the remainder of the month, sales tax must be paid by the 20th of the next month.

This proposal lowers the sales tax liability threshold for mid-month electronic filing from $25,000 per month to $10,000 per month. Currently, businesses with less than $25,000 in sales tax liability file paper returns once a month for the previous month's sales. These businesses will be required to remit electronically on a monthly basis, resulting in an additional sales tax payment in FY-2004. The additional revenue will increase collections by $7.4 million.

Sales Tax Permit Fee
Any entity selling tangible personal property in the state at a physical location or through a sales representative must have a sales tax permit. The fee is $20 and has not changed since 1986. Under this proposal, the sales tax permit fee will increase to $50. This results in an increase of $1.1 million in additional collections for FY-2004.

Discount for Paper Remittances
Currently, vendors who remit less than $25,000 in monthly sales tax may remit collections manually on paper forms. The State gives these vendors a discount on their monthly state and local sales tax liability if the return is filed on time. The discount rate is 2.25 percent and the discount amount is capped at $3,300.

Remitting sales tax collections by paper results in slower processing and uses more resources than electronic filing. This proposal lowers the discount rate to 1.25 percent for paper filers as a means to incent businesses to remit electronically. The fiscal impact is an increase in sales tax revenue of $257,000 for the state and $171,200 for cities and counties.

Abandoned Securities
Abandoned securities are the result of several different circumstances. One, a business looses contact with the owner of a security for over 5 years. Two, the owner places the security in a safety deposit box and forgets about it, or the owner dies and does not specify an heir for the security. Either way, the security must be turned over to the Treasurer's Office. Sometimes, the Treasurer will try to notify the owner if they can find an address. Otherwise, they post abandoned securities in the newspaper. If unclaimed, the Treasurer's Office holds the security for 2 years after which they sell it.

All 50 states have a program similar to Oklahoma for abandoned securities, and 19 states have a retention period of 1 year of less. This recommendation lowers Oklahoma's retention period to 1 year. If effective in FY-2004, the Treasurer's Office will be able to sell an additional $2 million worth of abandoned securities that they are currently holding. All of the additional revenue will be deposited in the General Revenue Fund.

Vending Machine Decal Fees
Businesses involved in vending machine sales are not required to pay a sales tax. Instead, they must purchase a vending decal for $50 a year. This fee is assessed in lieu of a sales tax. However, it has not grown as sales tax revenues would have. The current $50 fee equates to only $1,100 per year in sales. The State has not changed this fee since 1988. This budget proposes to increase it.

Effective July 1, 2003, the rate will increase to $100 resulting in an increase of $5 million. Decals must be purchased at the new rate and placed on the machines to reflect the fee increase prior to the effective date. On a one-time basis, 50% of the vending machine decal revenues will be apportioned to the Education Reform Revolving Fund and 50% to the General Revenue Fund. On July 1, 2004, the decal fee will increase to $150, increasing collections by $10 million, and 100% of collections will be apportioned to the General Revenue Fund.

Income Tax Compliance for Professional Business License
To operate a business in Oklahoma, the proprietor must purchase a business license. Businesses and their owners are expected to comply with all the Oklahoma laws, including the tax laws, in exchange for the opportunity to operate their business. This budget proposes implementing a tax compliance program for business licensing similar to the professional licensing program implemented in FY-2001. This will require a business to be income tax compliant in order to obtain or renew its license. This

program will match delinquent taxpayers with business license applications.

The Tax Commission and licensing agencies will begin to capture tax identification information in FY-2004 and will fully implement the program by FY-2005. The tax information will be used to determine compliance but will be kept confidential. Because of the effective date, there is not a fiscal impact for FY-2004. This program ensures that businesses and their owners are income tax compliant while they continue to do business in Oklahoma.

Income Tax Compliance for State Employees
The Tax Commission requires its employees to be in compliance with the state income tax. This proposal expands that requirement to all state employees. To be compliant, a taxpayer must have filed an income tax return and paid any state liability or negotiated a payment plan with the Tax Commission. Elected officials and local government employees are excluded. For FY-2004, the fiscal impact is an increase in income tax collections of $2 million.

Voluntary Use Tax Compliance
Use tax is levied on tangible personal property purchased outside the state to be consumed with in the state. While primarily collected through businesses, individuals also make purchases subject to the use tax. These are primarily from catalog sales. However, many people are unaware that they should pay it.

This proposal recommends adding a line for the voluntary remittance of use tax on state income tax returns to increase individual awareness and compliance. This voluntary use tax compliance is expected to increase collections by $416,000 for FY-2004.

Sales and Use Tax Compliance from State Contractors
To bid on a contract to provide a good or service for the State, businesses must submit a proposal to the Department of Central Services. If awarded the contract, the business sells the good to the State without charging sales and use tax. However, businesses are still required to collect sales and use tax on other sales.

Most states, including, Oklahoma, have compliance problems collecting sales and use tax from businesses, including state contractors. Recently, North Carolina implemented a program in which businesses must prove that they are collecting sales and use tax when submitting their proposal for a contract. After the law was enacted, they saw an increase in sales and use taxes from companies that had not previously been paying sales and use tax.

This budget recommends a similar program be implemented in Oklahoma. Businesses bidding on a contract must submit proof of a sales tax permit in the form of a copy of the actual permit or a permit number with their proposal to the Department of Central Services. If a business does not present proof, then they cannot be awarded the contract.

By ensuring that businesses have a sales tax permit, the State can expect better compliance with sales and use tax laws. The Tax Commission estimates an additional $1 million in FY-2004 collections mostly coming from sales tax revenue under this proposal.

Gross Production Tax-Natural Gas Incentive Rebates
In an effort to sustain the existing production of oil and natural gas in Oklahoma and encourage the drilling of new wells, the Legislature passed a rebate program that exempts most of the gross production tax through a refund process. The refund of tax was

made available to operators who reactivated non-producing wells, drilled new wells, or increased the production of existing wells. These refunds are contingent upon the yearly average price of oil and gas. In the event oil averages above $30 per barrel or gas averages $3.50 per thousand cubic feet, the refunds would not be available.

Producers have recently become more aware of the full potential for qualifying their wells. As a result, operators have been certifying projects that date back to the inception of the program in 1994. Since there is no limitation period for certifying wells, there have been an unexpected number of refunds paid for prior periods.

The Tax Commission has paid refunds for these claims which have doubled in number. During FY-2002, refunds totaled $38.4 million. For FY-2003, refunds are projected to be $70 million. As of December, the State has already paid $32.8 million in refunds. In FY-2004, these refunds are estimated to be $85 million.

This proposal calls for a time limit of 24 months for claiming a refund for a particular year. If a natural gas or oil well qualifies, then that producer only has 24 months to file for a refund. This will align the refund more closely with the cost of this type of production and be truer to the original intent of the program.

Certified Copies of Driving Records
The State charges $10 to persons attaining a certified copy of a driver record. This charge generated $11.7 million in FY-2002. In FY-2004, the Department of Public Safety forecasts that it will issue 1,220,000 certified copies of driver records. This budget proposes doubling the fee for such copies to $20. This generates an additional $12.2 million in revenue for FY-2004.

Quality Jobs Program
Oklahoma's Quality Jobs Program (QJP) has brought thousands of jobs to the state. When the program started in 1993, Oklahoma faced a much different economic climate than today. QJP began as a program designed to attract manufacturing jobs. In the years since QJP first began, Oklahoma grew from an economy in need of new jobs to one where the unemployment rate is consistently below the nation.

The focus in this environment must turn from simply attracting jobs regardless of the wage, to attracting jobs of true quality that pay our citizens a healthy, living wage. QJP currently considers only three main criteria to determine whether any applicant qualifies for the incentive payments:

- Minimum new payroll,
- Health insurance coverage provided to employees, and
- Industry of applicant.

In general, the minimum new payroll requirement of an applicant is $2.5 million and the business must be in a basic industry, in addition to offering health insurance coverage to employees.

If an applicant company meets these requirements, the Department of Commerce conducts a cost-benefit analysis. This analysis determines the benefit to the State of the new jobs, expressed by a net benefit rate (NBR). Components included in the NBR calculation include the income and sales tax paid by the new employees and additional costs to the state from in-migration. The incentive payments the company is eligible to receive equal the net benefit rate multiplied by the projected payroll over a ten year period. Total payments cannot exceed an amount equal to 5% of projected payroll over the ten year period.

There are no wage qualification criteria for the new jobs. A company can qualify and get quality jobs incentive payments if it creates 250 minimum wage jobs as long as the other requirements are satisfied. This is the first major weakness with QJP as it now operates.

The second major concern with QJP is that we pay for activity that would have taken place without the incentives. There is no perfect mechanism for screening QJP applicants to know which firms will create the new jobs without the incentive payments. It is clear, however, that some subtle changes to QJP will result in fewer companies receiving payments for jobs that would be created anyway.

Changes are necessary to address these problems with QJP and turn its focus from attracting any jobs to attracting jobs that are well paying. This proposal contains 6 changes to the Quality Jobs Program that will begin this transformation. The savings resulting from this proposal in FY-2004 will be $200,000.

First, only jobs with wages of at least $25,000 annually, exclusive of health benefits, will be eligible for inclusion in the minimum payroll for qualification. The minimum salary for inclusion in the qualifying payroll will increase annually by the rate of inflation as measured by the Consumer Price Index (CPI) from the Bureau of Labor Statistics. With this part of the proposal, the State will no longer give firms incentives to create jobs that are low paying. Additionally, this figure grows over time to avoid giving incentives in the future for a high wage today that may be low wage tomorrow.

Second, the minimum qualifying payroll figure will increase annually by the rate of inflation as measured by CPI. This part of the proposal will keep the focus of QJP on medium to large sized projects. Twenty years from now, $2.5 million in new payroll will be much different than it is today. Last year, the Legislature enacted a major expansion of the Small Employer Quality Jobs Program that addresses small business.

Third, firms receiving QJP payments must reach 60% of the minimum payroll as stated in their contract with the State by the 7th quarter in the program or payments will be suspended. The company will receive suspended payments if, and when, it reaches the 60% minimum payroll level prior to contract termination. This introduces a measure of accountability for firms not actively moving toward fulfilling their contract. Currently, such firms can continue receiving incentive payments for 3 years before being terminated from the program.

Fourth, firms in sectors considered as qualifying for QJP that are outside the manufacturing sector will qualify for QJP by one of two criteria:

1. 75% of sales must be to out of state consumers and all other QJP requirement apply.
2. Only salaries that are at least 150% of the minimum salary for inclusion can be included in the minimum payroll and all other QJP requirements apply. In FY-2004 this salary level will be $37,500, exclusive of health benefits.

The second of these criteria is new. This part of the proposal opens the door for non-manufacturing firms, such as research and development companies to qualify for QJP incentives if they have a sufficient number of very high paying jobs. These are exactly the type of jobs Oklahoma needs to attract.

Fifth, manufacturing firms applying for QJP on the basis of an expansion of current operations must make capital investment equal to or greater than the minimum qualifying payroll amount in addition to the other requirements of the program. Giving money to a manufacturing firm that is adding a second or third shift to expand its existing production levels would seem to be giving money away for activity that would have occurred anyway. This part of the proposal addresses this concern by requiring expanding firms to show that the new jobs could indeed be located elsewhere before the State will give them incentives to create the jobs here.

Finally, the QJP provision where the net benefit rate is automatically set at 5% in certain areas will be eliminated. QJP gives incentives to firms based on the value provided to the state. The measure of the benefit to the state is the NBR. By artificially setting the NBR to 5%, the State is giving more in incentives than the company provides in terms of additional tax revenue from the new jobs. This is a practice that the State cannot afford to continue.

The total effect of this proposal will be to narrow the focus of QJP. The target of the program will become high skill and high pay jobs instead of jobs for the sake of jobs. Further, this proposal tightens the program to minimize paying firms for activity that would have occurred without the incentives.

Fiscal Impact Summary for Proposed Tax Changes
($ in 000's)

Proposal:	FY-2003 Education Reform Rev. Fund	FY-2004 ($ in 000's) General Revenue Fund	Education Reform Rev. Fund	Teacher's Retirement Fund	Ad Valorem Reimb. Fund	Total Impact to Collections
Net Impact fromCigarette Change	-	$10,998	($2,769)	($941)	-	$7,288
Federal Refund Offset Program	-	3,920	375	159	45	4,500
Sales Tax Acceleration	-	6,388	774	263	-	7,425
Sales Tax Permit Fee Increase	-	1,100	-	-	-	1,100
Discount Rate Reduction for Paper Returns	-	221	27	9	-	257
Abandoned Securities	-	2,000	-	-	-	2,000
Vending Machine Decal Fee Increase	5,000	10,000	-	-	-	15,000
Income Tax Compliance for State Employees	-	1,742	167	71	20	2,000
Voluntary Use Tax Compliance	-	355	46	15	-	416
Sales Tax Compliance for State Contractors	-	860	104	35	-	1,000
Certifed copies of Driving Records (dbl to $20)		12,200	-	-	-	12,200
Quality Jobs Program	-	174	17	7	2	200
Total Fiscal Impact FY-2004	**$5,000**	**$49,960**	**($1,260)**	**($382)**	**$67**	**$53,386**

Source: Oklahoma Tax Commission

Taxes: Major Sources

The Oklahoma tax system is the primary source of funds used to finance state government. Tax revenue provides the means for state government support and provision of services to the citizens of Oklahoma.

Taxes comprised 52 percent of total treasury funds in FY-2001 and are the primary source of appropriations for the functions of government. The other 48 percent of total treasury funds is composed of dedicated revenues such as federal funds and fees for services provided.

There is a difference between taxes and fees. Generally, taxes are compulsory payments whereas fees are discretionary or voluntary. Avoiding the payment of fees often simply requires not using a service financed by the fees.

Not all tax revenues collected are available for general appropriation. Some taxes are dedicated to specific purposes, such as motor fuels taxes that are dedicated to highway and bridge construction and maintenance.

Many tax sources are partially dedicated for specific uses and partially available for annual appropriation. For example, portions of income tax revenue are dedicated to education, the Teachers Retirement Fund, and the Ad Valorem Reimbursement Fund. The remainder is available for general appropriations.

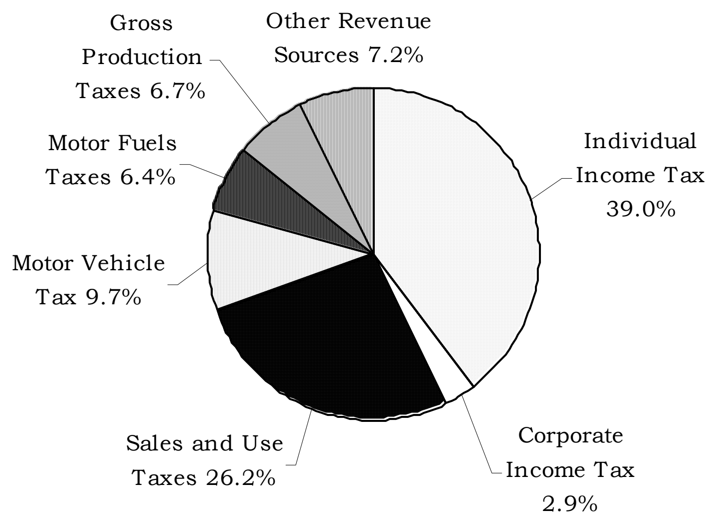
State taxes also provide a portion of the funding for local governments. The best example of this is the public school system. Public schools receive more of their funding from state revenue than through local revenue sources. Schools not only receive state funding through direct appropriations, but they receive dedicated funding from income taxes, sales and use taxes, gross production taxes, rural electric cooperative tax and motor vehicle taxes.

Oklahoma's tax system has changed over time to meet changing economic conditions and changing demands for revenue. When Oklahoma first became a state, state and local tax systems were based on gross production taxes on oil and natural gas and property taxes.

The first major change occurred in 1933 when the Oklahoma economy was under stress from both the Great Depression and the dust bowl. The hardships brought about as a direct result of the dust bowl days prevented many taxpayers from having the resources to pay property taxes. In response voters passed a constitutional amendment prohibiting a state levy on property taxes. Property taxes remained a major source of local revenue.

The six major tax categories for FY-2004, which provide 93% of total state tax revenue, are:

The Six Major Tax Categories FY-2004



Revenue Certification

As a part of the balanced budget process, the Board of Equalization certifies revenue estimates for the General Revenue Fund and other appropriated funds. This Board, created in the Constitution, is comprised of the Governor, Lieutenant Governor, Treasurer, Attorney General, State Auditor and Inspector, Secretary of Agriculture, and the State Superintendent of Education. The Board meets 3 times each fiscal year to review revenue.

In December and shortly after the start of legislative session, the Board certifies estimates to the General Revenue Fund and any special fund directly appropriated by the Legislature. The Board also meets in June to certify any changes to revenue estimates based on laws passed during the legislative session.

Estimated revenues for the upcoming fiscal year are presented for certification at each meeting. Appropriations are limited to 95 percent of total General Revenue and other certified fund estimates, plus any cash on hand. If collections are insufficient to cover the appropriations from that fund, the Constitution requires that appropriations be reduced proportionately to all agencies receiving an appropriation from the fund. The Legislature may make selective reductions in spending or consider revenue increases in regular or special session.

Revenues

The table below provides a recent history of total collections and certified revenues.

Summary of Certified Revenues
FY-2001 to FY-2004

	FY-2001 Actual	FY-2002 Actual	FY-2003 Estimate	FY-2003 Projection	FY-2004 Estimate
			$ millions		
General Revenue Fund					
Income Tax-Individual	1,982.1	1,987.7	2,169.8	1,930.4	1,998.9
Income Tax-Corporate	132.0	137.2	134.5	73.1	135.0
Sales Tax	1,240.6	1,241.9	1,327.3	1,213.9	1,245.0
Gross Production Tax-Gas	486.3	226.3	277.2	251.5	248.2
Motor Vehicle Tax	244.9	232.3	252.9	212.3	232.0
Interests & Investments	128.3	81.0	55.4	37.1	36.7
Other Sources	503.6	507.1	311.1	494.5	512.2
Total General Revenue	4,717.9	4,413.5	4,725.3	4,212.7	4,407.9
State Transportation Fund	195.3	201.6	202.7	210.7	210.0
All Other Certified Funds	36.4	37.3	35.9	35.1	33.5
Total	4,949.7	4,652.4	4,963.8	4,458.6	4,651.4

Source: Office of State Finance

Income Taxes

Oklahoma's income tax laws date back almost to the beginning of statehood. In 1915 an income tax was imposed upon the net income of individuals residing in Oklahoma and upon the Oklahoma portion of nonresidents' income. It was not until 1931 that the income tax was extended to corporations and banks.

Income tax increased in importance with the 1933 constitutional amendment that prohibited state taxation of property. While there have been numerous changes to income tax law since its beginning, today it is the single most important source of state revenue.
A unique feature of the Oklahoma individual income tax calculation is that two different methods are utilized. Method I employs rates ranging from 0.5% to 7% and does not permit deduction of federal income tax paid from net income. Method II employs rates ranging from 0.5% to 10% and permits the deduction of federal income tax paid from net income. In order to calculate individual income tax owed, a taxpayer calculates tax liability by both methods and pays the lesser amount.

Corporate income tax rates were also progressive when initiated in 1931. They remained progressive until 1935 when a flat rate of 6% was established. Although the rate was decreased to 4% in 1947, it was raised in two stages back up to its present level of 6% by 1990.

Individual Income Tax: The individual income tax is progressive. It reaches the top marginal rate at $21,000 and $24,000 taxable income for those married filing jointly under Method I and Method II respectively. For single taxpayers, the top rate is reached at $10,000 for Method I and at $24,000 for Method II.

Oklahoma's individual income tax uses federal adjusted gross income as its beginning point, adjusts for out-of-state income or losses, and then makes adjustments to arrive at the point that Oklahoma taxable income can be calculated. Oklahoma income tax is not levied on any social security income, the first $1,500 of military compensation, the first $5,500 of federal or state retirement and certain categories of private sector retirement of up to $5,500.

Taxpayers have the option of itemizing deductions or taking a standard deduction just as they have on their federal income tax. However, if they take the standard deduction on their federal return, they must do so on their state return. The standard deduction is either $1,000 for joint or individual returns or 15% of Oklahoma adjusted gross income but may not exceed $2,000 for either individual or joint filers.

If the taxpayers have itemized deductions on their federal return, they use the same value on the state return. The individual and dependent exemptions are $1,000 per person. Those who are blind and some low income elderly receive an additional exemption.

Credits or rebates to low and moderate income individuals began in 1990. The "Sales Tax Relief Act" provided an annual payment of $40 per person as a form of tax relief to low income families for the state sales tax paid on food. Originally, only families with income of less than $12,000, recipients of TANF or Medicaid recipients in nursing homes were entitled to the refund.

When the Sales Tax Relief Act was expanded in 1999, the maximum qualifying income was increased in two stages to $20,000 income for an individual with no dependents to $50,000 for an individual claiming one or more personal exemption other than the individual or spouse, or an individual 65 years of age or older.

Also in 1999, the individual income tax rate was cut from 7% to 6.75%. This tax relief, along with the expansion of the Sales Tax Relief Act, contained a provision that growth revenue must exist to maintain all tax relief levels. The Board of Equalization was delegated the responsibility for making the growth finding each year in Title 68 O.S. Supp 2000 Section 4001.B.

The Board must compare the revenue estimates for the coming fiscal year to the estimates for the current fiscal year. If there is growth, then the tax reductions remain in place. If not, then tax relief is temporarily suspended.

In 2001, the Legislature passed another individual income tax rate cut. Effective on January 1, 2002, the tax rate was scheduled to decrease to 6.65% from 6.75%.

However, when the Board of Equalization met in December 2001, they saw a total decrease in revenue estimates from FY-2002 to FY-2003. As a result, the tax cuts were suspended and the tax rate increased to 7% effective January 1, 2002. Additionally, the qualifications for the Sales Tax Relief Act were tightened.

At its December 2002 meeting, the Board of Equalization found again that growth revenue did not exist between FY-2003 and FY-2004. Accordingly, the individual income tax rate remained at 7%. The Sales Tax Relief qualifications were further lowered from $30,000 to $12,000 income per household. The tax relief will remain suspended until the Board makes a future finding that growth exists, at which point the tax rate will decrease to 6.65%.

The Quality Jobs program, an economic development incentive, is placing an increasing demand on state tax revenues. New and expanding firms qualifying for the Quality Jobs programs are refunded up to 5% of their total payroll amount from individual income tax withholding payments. The Quality Jobs program is estimated to decrease net state income tax collections by $60 million in FY-2004.

During the 2002 session, the Legislature passed the Tax Amnesty Bill. Under the new law, the Tax Commission could waive penalties and half of the interest due on delinquent individual income tax liability. To receive amnesty, the taxpayer had to pay the remaining interest and tax liability between August 15, 2002 and November 15, 2002. However, the program is only offered under the following circumstances:

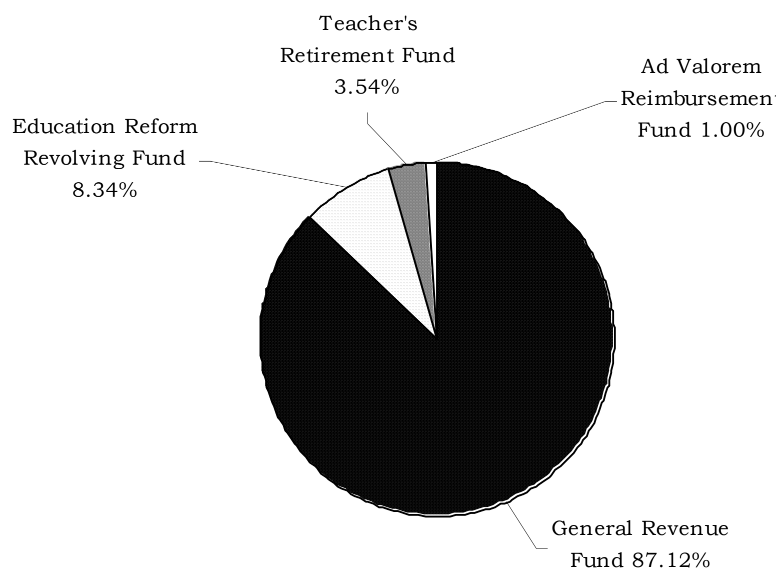
- Under-reporting of tax liability
- Nonpayment of taxes
- Nonreporting of tax liability

Penalties and interest accrued from delinquent motor vehicle tax and ad valorem tax do not qualify under this program.

The Tax Amnesty bill also specified a one-time change in individual income tax apportionment. For FY-2003, the first $5.8 million in revenue will be deposited directly into the Education Reform Revolving Fund. Once this total is reached, the remaining revenue is apportioned following established apportionment percentages.

The chart below shows how Individual income tax revenue is apportioned.

Individual Income Tax Apportionment FY-2004



Source: Oklahoma Tax Commission

Corporate Income Tax: While corporate income tax is important to the overall revenue picture, it provides only about 2.9% of total tax revenue. Over time, corporations subject to corporate income tax have become a smaller part of the overall economy. This is due, in part, to the fact that many businesses now organize as subchapter S corporations or limited liability organizations.

Under these two classifications, all income immediately goes to the partners or shareholders, and as a result, the corporations pay no income tax. The partners or shareholders, rather than the business, are taxed on that income as well as income from other sources under the individual income tax. In addition, some corporate businesses may be subject to some other forms of taxation such as the bank privilege tax or the insurance premium tax.

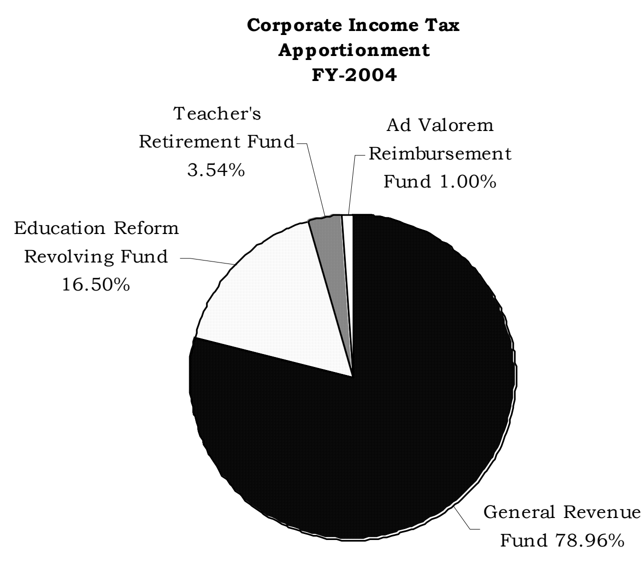
The corporate income tax rate is a flat 6% that is applied to all taxable income. Manufacturers' exemptions and some targeted credits and incentive payments are frequently used as economic development tools and reduce a company's income tax liability.

The largest of these targeted incentive programs are the Quality Jobs programs. Estimated refunds are $60 million in FY-2004. While the refund is made to businesses, it is made from individual income tax withholding receipts.

In 2002, Congress enacted the "Job Creation and Worker Assistance Act of 2002" as part of an economic stimulus package. One major provision allowed companies to deduct from corporate income tax liability an additional 30% of depreciation for certain business investment. To minimize the negative influences on revenues, the State enacted legislation decoupling depreciation from the federal return. For the first year, companies can only deduct 20% of the bonus depreciation allowed under the federal act. The remaining 80% of depreciation must be added back into taxable income. For the following four tax years, companies can only deduct 25% of the 80% depreciation added back from the first year.

Legislation also included amnesty for corporate income tax. The program was identical in design to the individual income tax amnesty. This included a one-time change in apportionment for FY-2003. The first $41.2 million in corporate income tax revenue will be apportioned into the Education Reform Revolving Fund. Once this total is reached, revenue collections for the rest of the fiscal year are apportioned following the apportionment percentages.

The chart below shows how Corporate Income Tax is apportioned.



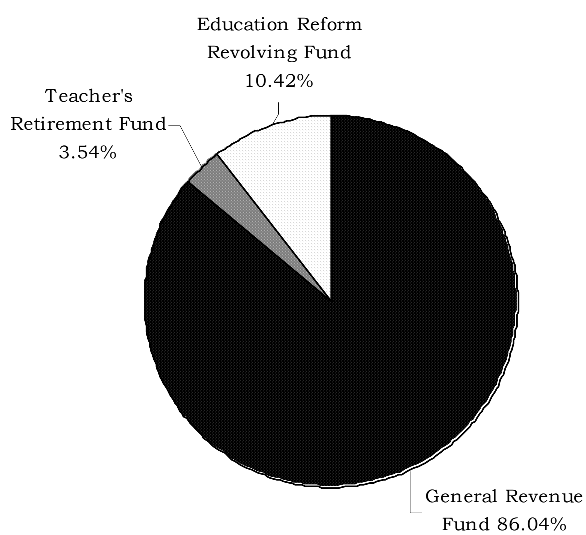
Source: Oklahoma Tax Commission

State Sales and Use Taxes

The State's sales tax has varied considerably in both rate and purpose since its initial imposition in 1933, when a temporary 1% tax was dedicated to public schools. Two years later, the tax was renewed, but the revenue was apportioned to the General Revenue Fund. In 1939, the rate was increased to 2% with 97% of the revenue being apportioned to the State Assistance Fund (i.e. welfare) administered by what is now the Department of Human Services.

This sales tax dedication continued until the 1980s when all collections were apportioned to the General Revenue Fund. Since then, the General Revenue Fund has been the primary source of state funds for the Department of Human Services. The chart below shows how Sales tax is apportioned.

Sales Tax Apportionment
FY-2004



Source: Oklahoma Tax Commission

During the state funding crisis brought on by the decline of the petroleum industry in the 1980s, the tax rate was incrementally increased to 4%. In 1990, the Education Reform Act (HB 1017) was passed which increased the sales and use taxes to their current level of 4.5%.

The state sales and use taxes are imposed on sales of tangible personal property and on the furnishing of some services such as transportation, meals, and lodging as well as on some telecommunications services.

However, most services are not subject to the sales and use taxes. Beyond those exemptions allowed when the product or service is subject to another tax such as the motor fuels tax, there are specific exemptions made to governmental and nonprofit entities, agriculture, and to certain areas targeted to encourage economic development.

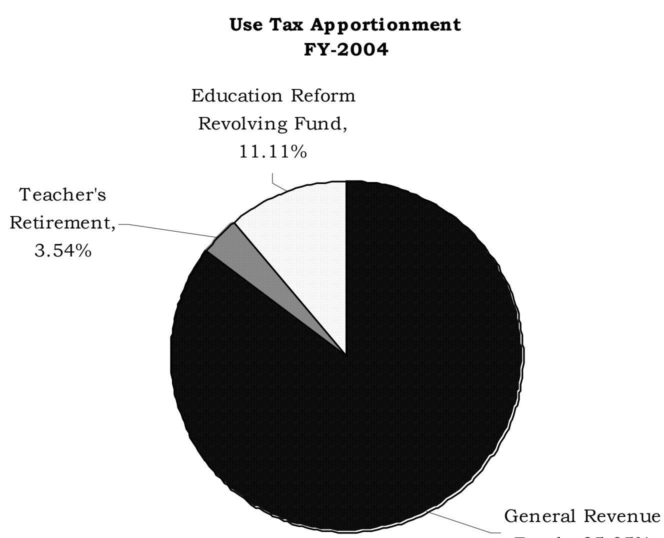
The values of some of the large remaining exemptions to sales and use tax for FY-2002 are:

- sale of natural or artificial gas and electricity for residential use, $82.2 million
- sale of prescription drugs, $50.3 million;
- sales of advertising space, $38.6 million.

During the 2002 session, lawmakers approved the use tax acceleration provision which is similar to sales tax acceleration already in place. If use tax liability is more than $25,000 per month, then the taxpayer is required to remit use tax electronically. For tax levied on the 1st through the 15th of the month, the payment is due on the 20th of that same month. For taxes levied for the remainder of the month, use tax is due by the 20th of the next month.

Lawmakers also included sales tax in the Tax Amnesty bill. The specifications on sales tax amnesty are identical to those under income tax amnesty. The same legislation also specified a one-time change in apportionment. The first $5.4 million of sales tax revenue and the first $1.1 million of use tax revenue will be deposited into the Education Reform Revolving Fund. Once the full amount is deposited, the revenue collected for the remaining fiscal year is apportioned in the same percentages as last year.

The chart below shows how Use Tax is apportioned.



Source: Oklahoma Tax Commission

Motor Vehicle Taxes

Motor vehicle taxes and fees have a long history in Oklahoma. Oklahoma City was the birthplace of the parking meter in 1913 and, in fact, Oklahoma City tagged "horseless carriages" before the state did.

Motor vehicle taxes are comprised of a broad category of taxes and fees imposed on the purchase and use of motor vehicles. The motor vehicle taxes include an excise tax levied on the purchase of cars, trucks, buses, boats, and motors as well as annual registration fees.

The apportionment of motor vehicle registration or tag fees changed when State Question 691 (SQ-691), in 2000, made registration fees based on the age of the vehicle:

Years 1 - 4	$85 annually
Years 5 - 8	$75 annually
Years 9 - 12	$55 annually
Years 13 - 16	$35 annually
Years 17 +	$15 annually

The registration fees are in lieu of ad valorem or personal property taxes.

The motor vehicle excise tax was also changed. Previously the tax was charged at 3.5% of value which was determined by the factory delivered price depreciated at 35% annually. The new law leaves the rate at 3.5% but changes the base to the actual cost of the vehicle. This tax is in lieu of state and local sales taxes.

While other taxes and fees are collected directly by state and local governments, motor vehicle taxes are collected by independent businesses operating as motor license agents or tag agents. The only exception to this is the taxes and fees imposed on trucks and trailers used in interstate commerce, which are collected by the Oklahoma Tax Commission.

Prior to FY-1986, there was a different apportionment for virtually every motor vehicle tax and fee collected. This was remedied by combining all motor vehicle tax collections into one category and then apportioning revenue from that category.

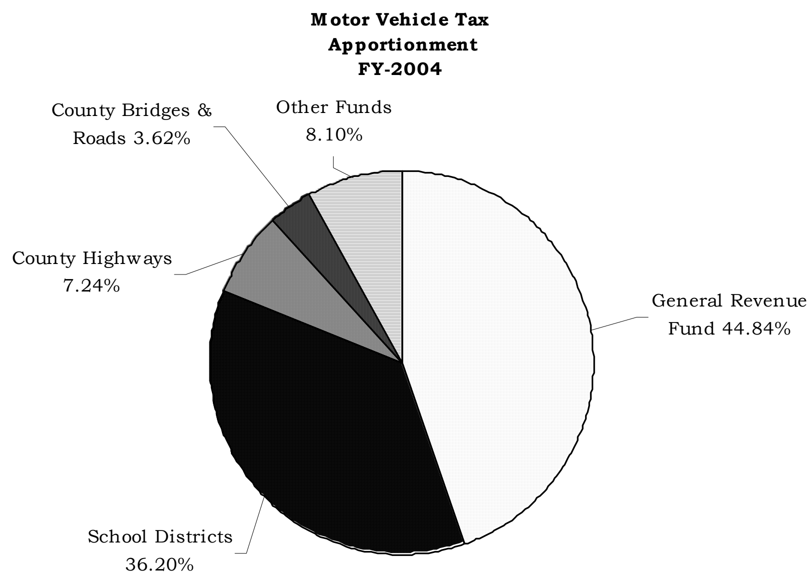
SQ-691 changed the apportionment of motor vehicle taxes as well. Monies apportioned to school districts from this source are "held harmless" under this law. Effectively, no district will receive less from this source than it did in the corresponding month of the preceding year.

Many people are surprised to learn that so small a percentage of motor vehicle taxes are used for roads. However, the tax has traditionally been considered in lieu of a property tax rather than a road user tax. In Oklahoma, automobiles are exempt from property taxes.

There are reductions in annual fees for vehicles used primarily for commercial or business purposes. Farm vehicles and pickups used primarily for agricultural use have a reduced fee of $30. License fees for large commercial trucks and trailers are based on the combined weight of the loaded vehicle. Commercial truck tractors and commercial trailers operating in interstate commerce pay fees in proportion to their use of Oklahoma highways. Prorated licenses are issued only by the Oklahoma Tax Commission rather than through local tag agents.

In the 2002 session, lawmakers passed a bill that gives insurance companies flexibility when dealing with the ownership of a stolen vehicle. Under prior law, the insurance company had to visually inspect a stolen vehicle before ownership could be transferred to the company. However, many times, the vehicle is never found making a visual inspection impossible. Therefore, the new law does not require an insurance company to do a visual inspection. The title of the stolen vehicle can be transferred to the company by a salvage title if the vehicle is declared a total loss.

The chart below shows how Motor Vehicle Tax is apportioned.



Source: Oklahoma Tax Commission

Motor Fuels Taxes

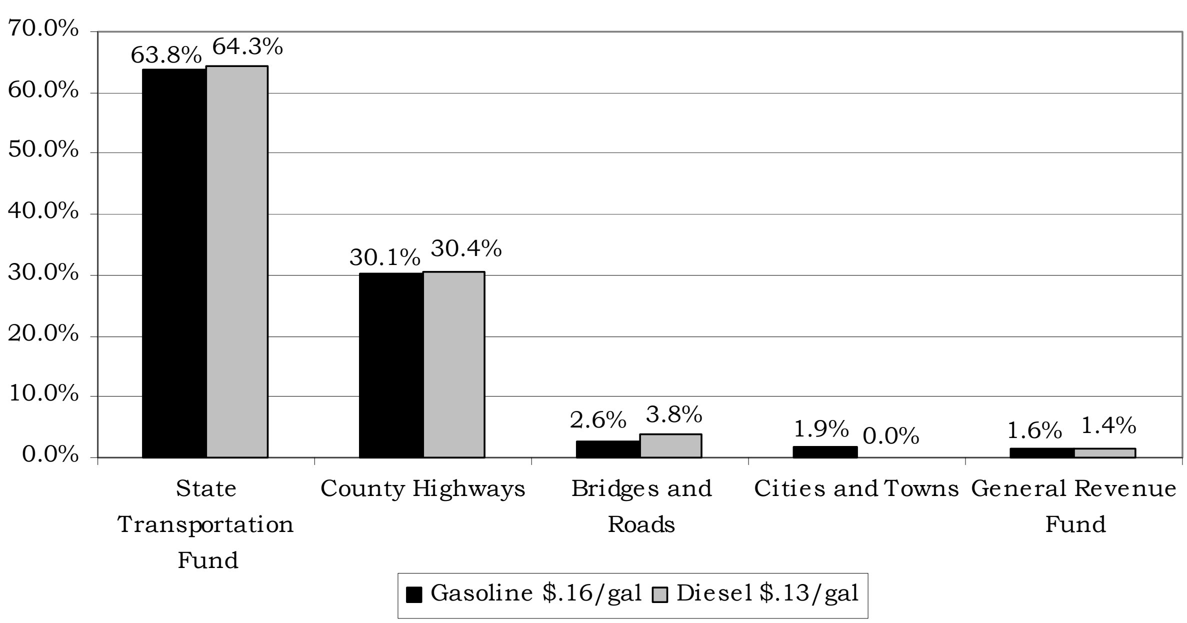
The first gasoline tax became effective in 1923 and was used for the construction and maintenance of roads and bridges. Prior to 1923, local governments were responsible for roads and bridges which were supported through ad valorem tax revenue. In 1910 local roadways were maintained by requiring able bodied males to provide four days of labor per year -- less if they brought their own horse. Those so inclined could pay three dollars per day in lieu of work. By 1916, a two mill tax was levied in townships to supplement the work requirement but both were completely abolished in 1933.

The motor fuels taxes in Oklahoma are a form of selective sales tax and include the gasoline and diesel excise tax, the motor fuel importer use tax, and the special fuel use tax. The taxes are levied on the quantity or volume of fuel sold, not the price. The state tax on gasoline and special fuels is 16 cents per gallon, plus a 1 cent per gallon assessment. The state tax on diesel fuel is 13 cents per gallon, plus a 1 cent per gallon assessment.

The chart below shows the FY-2004 apportionment of the diesel and gasoline tax and motor fuel revenue. The motor fuels tax revenue supports roads and bridge building plus maintenance for both state and local governments. A 1 cent per gallon special assessment provides for environmental cleanup of leaking petroleum storage tanks. Almost one third of the total motor fuel revenue is apportioned for local uses with the remainder used for state purposes. The incidence of the motor fuel taxes falls on the consumer just as sales taxes do. This incidence was defined by statute during the 1996 legislative session as the result of a court ruling that whoever actually paid the tax should be specified in the statutes. Although the statutes identify the consumer paying the tax, it is collected and remitted at the terminal rack or refinery level.

There are some major exemptions to the payment of motor fuels taxes. All government entities are exempt and fuel used by all recognized Indian tribes for tribal government purposes may be exempt. The tax paid on diesel fuel used off road and for agricultural purposes may be refunded upon application to the Oklahoma Tax Commission. Oklahoma is in a unique position with its large number of Indian tribes. The tribes may request a refund for tax paid on motor fuel used for tribal purposes.

Gasoline Tax and Diesel Tax Apportionment FY-2004



Source: Oklahoma Tax Commission

Alternatively, the tribes may enter into a contract with the State to receive a portion of the motor fuel tax collections and must agree not to challenge the constitutionality of the motor fuel tax code. This law permitting the sharing of motor fuel tax revenue went into effect in 1996.

The Tax Amnesty bill, passed in 2002, included gasoline tax. Qualifications to apply for gas tax amnesty are identical to individual income tax amnesty. The bill also contained a one-time apportionment change for gasoline tax. The first $200,000 of revenue is deposited into the Education Reform Revolving Fund. Revenue collected for the remaining fiscal year will be distributed similar to the apportionment from last year.

Gross Production Taxes

Gross production, or severance, taxes are imposed on the removal of natural products, such as oil and gas, from land or water and are determined by the value and quantity of the products removed.

Gross production taxes placed on the extraction of oil and gas were separated from the ad valorem property tax in 1910. For the first 20 years of statehood, oil and gas gross production and the ad valorem property tax were the major sources of revenue. While the ad valorem property tax became strictly a local tax in the 1930s, the oil and gas gross production taxes have continued to be an important source of revenue for state government, schools, and roads.

The energy industry has been an important component of the Oklahoma economy for many years. Other sectors such as manufacturing and services have become a larger portion of the Oklahoma economy, but the health of the oil and gas industry remains a major influence on the state's economy. The continued downward trend in Oklahoma's oil production reflects basic geologic and economic fundamentals.

Oil is a world commodity whose price is beyond the control of Oklahoma and the nation. Other nations have oil in abundance at low production prices, therefore the oil industry is expected to continue to slowly decline in Oklahoma.

Gross Production Tax - Natural Gas: In 2002, the Legislature passed a three-tiered tax rate structure based on price per thousand cubic feet (M`CF), replacing the flat tax of 7%. When the price of gas is greater than $2.10, the tax rate stays at its current level of 7%. If the price falls between $2.10 and $1.75 per mcf, then the tax rate decreases to 4%. Any price below $1.75 results in a tax rate of 1%. This is similar to the tax on oil.

FY-2003, the above chart shows the apportionment for Gross Production Tax on Natural Gas into the following funds: General Revenue Fund, County Highways, and School Districts.

The following table shows the change in apportionment to the various funds when the tax rate changes.

Gross Production Tax-Natural Gas
Change in Apportionment

Tax Rate	General Revenue Fund	County Highway Fund	School Districts
7%	85.72%	7.14%	7.14%
4%	75%	12.50%	12.50%
1%	0%	50%	50%

Prior to FY-2000 schools, roads, the General Revenue Fund and the Teachers Retirement Fund received revenue from gas gross production.

In FY-2000 the revenue formerly apportioned to the Teachers Retirement Fund was redirected to the General Revenue Fund. In exchange, the Teachers Retirement Fund is apportioned 3.54 percent of individual income tax, corporate income tax, state sales tax and state use tax.

Gross Production Tax - Oil: Legislators met in special session in 1999 to provide relief to the oil industry which was adversely impacted by low oil prices. Prices were below $14 per barrel and were estimated to remain there for the near future.

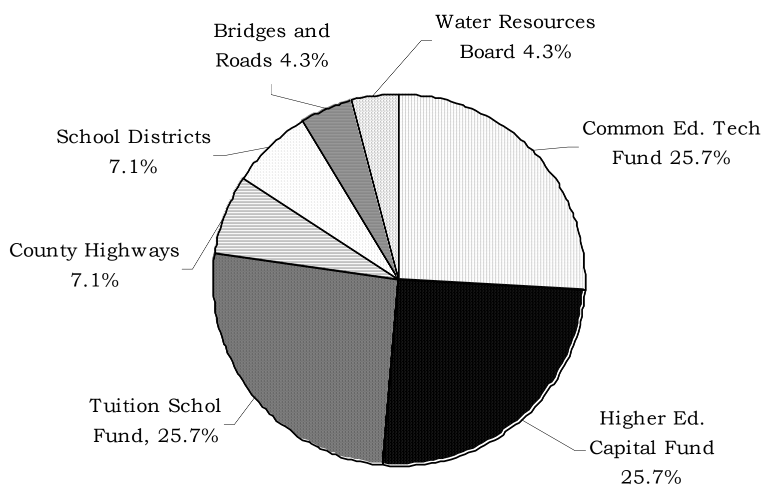
Lawmakers instituted a three tiered rate structure for the gross production tax on oil. The price of oil determines the applicable tax rate which is 7% when the price is greater than $17 per barrel, 4% when the price ranges from $14 to $17 per barrel and only 1% when the price is less than $14 per barrel.

Revenue apportionment also underwent major changes. Revenue formerly apportioned to the General Revenue Fund was redirected to 5 different funds. However, no changes impacted that portion of revenue dedicated to county highways and school districts. Two existing revolving funds, the County Bridge and Road Improvement Fund and the Water Resources Board REAP Fund, received a portion of the revenues for their stated functions. Three new funds, which dedicated the revenue to specific education uses, also were created. Later legislation changed the three education funds to revolving funds.

The maximum total apportionment of revenue to these five funds from this source is capped at $150 million. Revenue exceeding $150 million is apportioned to the General Revenue Fund.

The chart below shows the apportionment to each of the 7 funds.

Gross Production Tax-Oil Apportionment FY-2004



Source: Oklahoma Tax Commission

Estate Tax

The estate tax is a tax on the transfer of assets from one generation to the next. Oklahoma's estate tax is separate from any federal estate tax. The Oklahoma estate tax has some similarities to an inheritance tax since the tax rate depends on the relationship of the heir to the deceased individual.

The Oklahoma estate tax starts at the first dollar for non-lineal heirs but allows an exemption for inheritance by lineal heirs. This exemption is $700,000 in calendar year 2003 and will gradually increase for lineal heirs until it $1 million in 2006.

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A modern version of an inheritance tax was first enacted in 1915 and remained basically unchanged through 1935. In 1935, the law was changed from an inheritance tax to what was defined as an estate tax with a graduated tax rate applied to the estate of the deceased.

The Tax Amnesty passed in 2002 legislative session included a program for estate tax identical in design to the income tax amnesty program. The bill also specified a change in apportionment for FY-2003. The first $1.4 million in estate tax collections will be deposited into the Education Reform Revolving Fund. The revenue collected for the rest of the fiscal year goes entirely to the General Revenue Fund.

Beverage Taxes

Oklahoma first permitted the sale of non-intoxicating alcoholic beverages (beer with no more than 3.2% alcoholic content by weight) in 1933. It was not until 1959 that the prohibition era ordinance on intoxicating alcoholic beverages was repealed; however, intoxicating beverages could not be sold by the drink to the general public. In 1984, a constitutional amendment first permitted mixed beverages to be sold to the general public on a county option basis.

The alcoholic beverage tax is primarily levied on package store sales of wine and alcoholic beverages. Alcoholic beverages include spirits, wine and beer that measures more than 3.2% alcohol by weight. Beer with an alcohol content of 3.2% or less is considered to be a non alcoholic beverage and is frequently called low point beer. For the alcoholic beverage tax (package store sales), 32% is apportioned to cities and towns, 65% is apportioned to the General Revenue Fund and 3% is apportioned to the Oklahoma Tax Commission Fund. All of the mixed beverage tax and alcoholic beverage stamp tax are apportioned to the General Revenue Fund.

The tax rates vary depending on the type of beverage and the alcohol content as shown in the table below.

Alcoholic Beverage Tax Rates

Light Wine	0.19/liter
Wine (greater than 14% alcohol)	0.37/liter
Sparkling Wine	0.55/liter
Spirits	1.47/liter
Beer (greater than 3.2% alcohol)	12.50/31 gal. barrel
Beer (3.2% or less alcohol)	11.25/31 gal. barrel
Mixed Beverages	13.5% of price

Source: Alocoholic Beverage Law Enforcement and Oklahoma Tax Commission

Cigarette Tax

The legislature first enacted a cigarette stamp tax in 1933. The initial tax was three cents per package of 20 cigarettes and has gradually increased to $0.23 per package.

For many years the major apportionment of this revenue has been for support of debt service on state bonds. The debt service payment for FY-2003 is $24.6 million, 52.4% of the estimated revenue from the cigarette tax. The General Revenue Fund is apportioned any cigarette tax revenue not used for debt service.

The Master Settlement Agreement between tobacco companies and the states is not a tax; rather it is payment to the states for costs resulting from tobacco use incurred by the states in previous years. The Agreement apportions 1.036137% of the adjusted settlement payments to Oklahoma.

Continuous adjustments to settlement payments will affect the amount received by Oklahoma. Major adjustments are calculated for inflation, volume and a subtraction from the annual total for the four states that settled prior to the Agreement (Florida, Texas, Mississippi and Minnesota).

MASTER SETTLEMENT AGREEMENT
Oklahoma's Estimated Share

Share of total 1.036137%

2000	61.0
2001	65.2
2002	78.2
2003	79.0
2004	69.1

$ millions
Source: FFIS "Issues Brief 99-16, Estimating Tobacco Payments", 8/20/99

Corporate Franchise Tax

The corporate franchise tax is imposed on all domestic and foreign corporations doing business in Oklahoma. It is based on the corporation's capital or equity plus long-term indebtedness at the rate of $1.25 per thousand dollars invested or employed within Oklahoma but has a minimum of ten dollars and a maximum of $20,000.

Forty-two thousand Oklahoma corporations paid only the minimum $10 franchise tax in FY-2001, 31,000 paid between $10 and $499, while only 582 corporations paid the maximum $20,000. Therefore, 88% of the corporations paid less than $500.

All corporate franchise tax revenue is apportioned to the General Revenue Fund.

Workers' Compensation Insurance Premium Tax

Workers' compensation insurance tax has two major components. First, self insured employers pay 2% of total compensation for permanent total disability awards, permanent partial disability awards and death benefits. Second, all other insurance carriers pay 1% of all gross direct premiums. The revenue is directed to the General Revenue Fund.

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