



**2025**

# PRO-GROWTH TAX REFORM FOR OKLAHOMA

JARED WALCZAK | MANISH BHATT | JOSEPH JOHNS



TAX FOUNDATION

## Introduction

[Oklahoma](#) policymakers have been grappling with [tax](#) reform for decades, spurred by a desire to enhance the state's competitiveness, and particularly by the success of the state's neighbor to the south, which has harnessed a competitive tax system and other pro-growth policies to attract people, jobs, and businesses. Recently, lawmakers have enacted pro-growth and competitive reforms, but there remains important work to do in addressing the structural inefficiencies that keep Oklahoma from realizing its full potential.

This publication is designed to update our 2021 study and provide policymakers with a menu of options: some of them bold, comprehensive approaches and others small standalone policy tweaks, but all designed to make Oklahoma a more attractive place to live and work. Each major tax category—individual income taxes, corporate income taxes, sales taxes, and *ad valorem* and other property taxes—is considered in turn, with discrete reform options within each tax category. Additional options, however, cross categories, identifying ways to reform two taxes in tandem to maintain revenue neutrality while shifting toward more economically efficient forms of taxation.

## Reforms Since 2021

Since 2021, Oklahoma lawmakers have made concerted efforts to make the state's tax code more competitive and friendly to residents and businesses. This has included reductions in corporate and [individual income tax rates](#), elimination of the state's capital stock tax (franchise tax), and elimination of the [marriage penalty](#).<sup>[2]</sup>

In 2022, corporate income taxpayers became subject to a competitive flat rate of 4 percent, down from 6 percent, tying Oklahoma with [Missouri](#) for the second lowest rate in the nation among states with a traditional [corporate income tax](#). Moreover, in 2023, Oklahoma became the first state to adopt permanent first-year [full expensing](#) for qualifying investments in machinery and equipment, followed by [Mississippi](#) (2024) and [Louisiana](#) (2025). This boosted the state's competitiveness, particularly as the federal provision began to phase out, leaving those states that continue to conform to the federal provision less competitive in this regard.

At the same time, Oklahoma reduced its individual income tax by 0.25 percentage points across the board. Accordingly, the top rate—previously 5 percent—declined to 4.75 percent, the sixth lowest of states that levy an income tax. While the rate reduction is competitive, the individual income tax code still features six brackets and is not indexed for [inflation](#), exposing taxpayers to [bracket creep](#), which occurs when inflation pushes a taxpayer from a lower bracket to a higher one when nominal income rises, but due to inflation, real income does not, or may even decline. And while Oklahoma's brackets are quite narrow, rendering these effects small, adopting a single-rate tax can help lock in a competitive rate for years to come.

These rate cuts reduced state revenue, but Oklahoma policymakers identified an opportunity to pay for them out of growth. Oklahoma, like many other states, saw revenues increase during the pandemic. Although most of the revenue growth consisted of one-time funds, the state still experienced an increase of \$552 million in recurring revenue,<sup>[3]</sup> with tax revenue growth of 5 percent in the general fund between fiscal years 2019 and 2021, sufficient to pay down permanent rate reductions.<sup>[4]</sup>

Oklahoma was not the only state with an eye on tax competitiveness in recent years. Since 2021, with burgeoning revenues in the wake of the coronavirus crisis and the prospect of

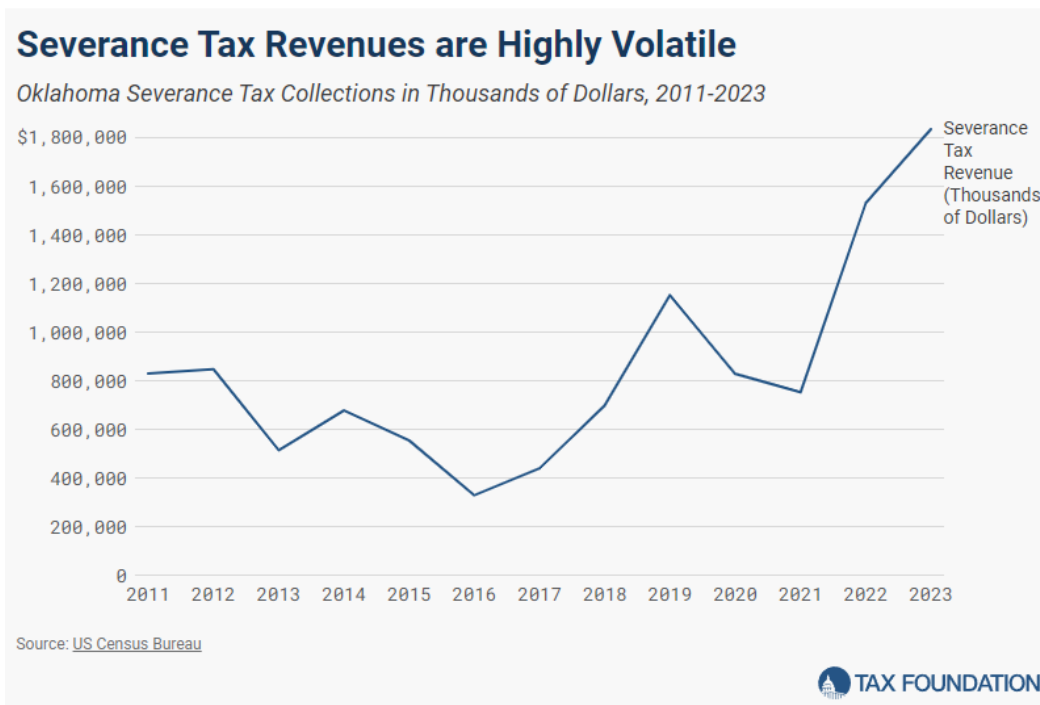
workplace flexibility greatly enhancing the salience of tax competition, 28 states cut individual income tax rates and 15 states cut corporate income tax rates, some doing both.

The COVID-19 pandemic and subsequent years ushered in a time of substantially more revenue than expected. This is true even when looking exclusively at tax or other own-source revenue, and excluding all federal transfers under the CARES Act, the American Rescue Plan Act (ARPA), or other federal legislation enacted in response to the pandemic. [Taxable income](#) grew during this time, partly due to those time-limited federal infusions, but largely because longer-term economic trends continued almost unabated. States emerging from the public health crisis not only with adequate revenue, but in many cases robust growth, recognized an opportunity for tax relief. Many policymakers across the country saw it not just as an opportunity but as a necessity, a way of demonstrating their state’s commitment to tax and overall economic competitiveness in an increasingly mobile world, and Oklahoma was no exception.

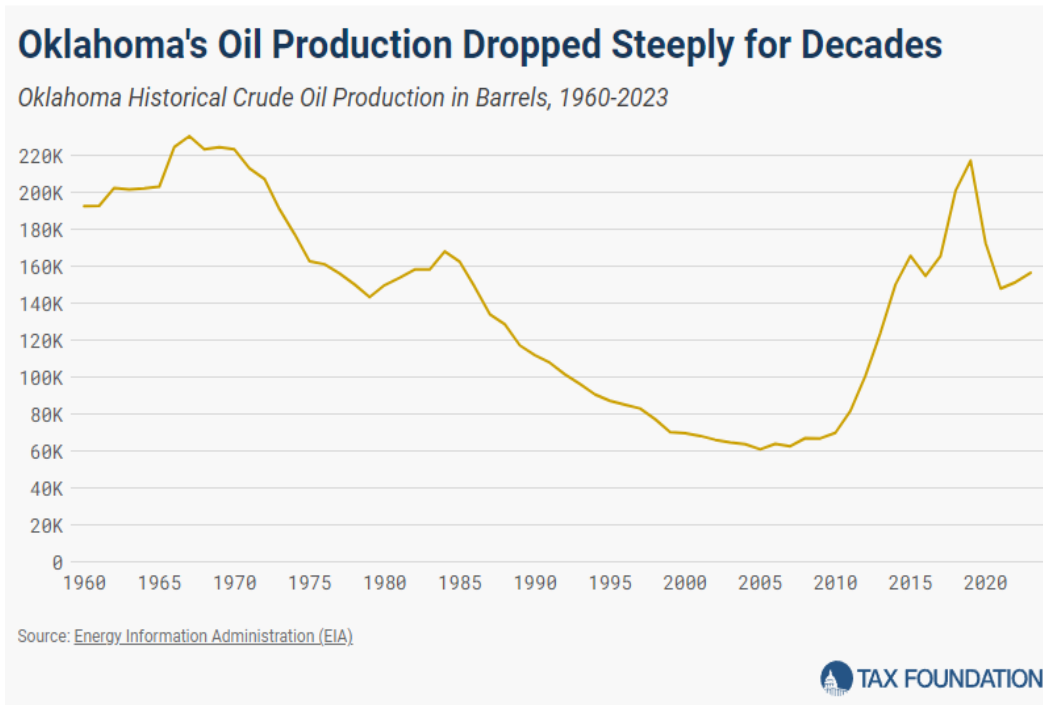
## Reliance on Severance Taxes

Oklahoma’s continued reliance on the severance tax, which is imposed on the extraction of oil and other minerals, should provide additional motivation for tax reform. Severance taxes represented the third highest tax revenue generator for the state in fiscal year 2023, behind income and sales taxes, and comprised 12.75 percent of state tax collections in fiscal year 2023.<sup>[5]</sup> While this is far from the state’s main source of revenue, fluctuations in the oil and gas industry can affect the state’s financial footing.

As helpful as this revenue can be, severance tax collections are extremely volatile, and a significant reliance on them as a funding source can create difficulties for revenue estimation and budgeting. From 2011 to 2023, the state saw severance revenues range from \$331 million to \$1.8 billion (in nominal dollars).



Since the 1960s, crude oil production in the state has also seen large fluctuations. Production reached a high in 1966 but dropped steeply in the 1990s and early 2000s. Since 2010, production has once again picked up, but Oklahoma cannot count on this trend to continue forever, especially with the rise of alternative energy sources. Oil, gas, and other natural resources will continue to play an important role in Oklahoma for the foreseeable future, but policymakers need to focus on diversification to prepare for a decline in the resource sector's fortunes.



Oklahoma is seeking to gain ground in new energy sectors, or in new industries entirely. However, the state tax code includes many elements that may hold back the state in this endeavor. The state's throwback rule disadvantages businesses that sell out of state, and the tax on inventory disadvantages businesses that sell within the state. The elimination of full expensing is a bold reform which targets manufacturers and other capital-intensive industries—precisely the businesses that Oklahoma will be looking to attract. Nevertheless, many individuals and businesses will continue to look to neighboring [Texas](#), which forgoes an individual income tax, as an attractive alternative.

Consequently, lawmakers still have work to do to make improvements to Oklahoma's tax code. They should seize the opportunity to implement tax reforms that improve the state's competitiveness and enhance its appeals to employers and employees alike. Oklahoma has long recognized the need for a growth agenda, and while the state has made significant steps in the right direction, policymakers should recognize that tax competition is real and work to propel the state forward rather than wait for others to catch up.

## Corporate Income Taxes

The corporate income tax is levied at a flat rate of 4 percent, tying the state with Missouri for the second-lowest rate in the nation, surpassed only by [North Carolina's](#) 2.5 percent among states



with a corporate income tax. The ideal rate of taxation on capital is zero, and corporate income taxes are a form of [double taxation](#) since income is taxed again when distributed or taken in salary. Nevertheless, all but two states have either a corporate income tax, a gross receipts tax, or both. Corporate income taxes are preferable to [gross receipts taxes](#), and Oklahoma's rate remains highly competitive.

Despite the low rate, however, Oklahoma's corporate income tax advantage is hindered by several structural impediments. A throwback rule dramatically increases corporate income tax costs for some in-state businesses. Moreover, the state's three-factor [apportionment](#) formula is increasingly out of line with a national trend toward single sales factor apportionment, which eliminates the tax's bias against in-state investment. Recent efforts to amend the apportionment formula could have yielded positive gains for Oklahoma, but did not gain the necessary traction in the legislature.[\[6\]](#)

Oklahoma's decoupling from the federal policy of full expensing of capital investment signaled the state's commitment to a pro-growth tax code. Amending other policies would further enhance Oklahoma's competitiveness. Addressing these issues within the corporate tax code would enhance the state's attractiveness for C corporations at a time when mobility is at record highs.

## The Throwback Rule

Ask most people what a throwback rule is, and they may explain the local requirement to throw back a visiting team's home run from the hometown bleachers. Ask a member of the business community and she is likely to tell you about how the tax has affected her business. While opaque to the average citizen, the business community clearly understands the impact of the throwback rule due to its dramatic effect on a firm's taxable income. It has also been shown to affect business location decision-making. Not unlike other complex tax policies, throwback rules are often enacted with one intent but end up causing unintended consequences.

However, before we can address the uncompetitive nature of throwback rules, it is first necessary to explain why they exist, how they work, and where they fit into a corporate income tax.[\[7\]](#)

## Apportionment In Oklahoma

When C corporations conduct business in multiple states, it is necessary for states to apportion that income for tax purposes. That means they must determine what share of their income is taxable in each involved state.[\[8\]](#) Currently, states can use three factors in their apportionment formulas: the share of total property, payroll, and sales that a firm has located in each state. Historically, most states weighted these factors evenly. However, there is a pronounced trend toward giving greater—or even exclusive—weight to the sales factor. Doing so generally benefits in-state companies while exporting some of the tax burden to companies with sales, but less of a physical presence, in that state.[\[9\]](#)

The apportionment technique can make a huge difference in businesses' tax burdens. [Iowa](#), for example, has a high corporate income tax top rate of 9.8 percent, but manufacturers often face light corporate income tax burdens due to the state's single sales factor apportionment. [\[10\]](#) On the other hand, [Montana](#) has a lower top rate of 6.75 percent, but it employs an evenly weighted three-factor apportionment formula. This creates an above-average corporate income tax burden on many manufacturers.[\[11\]](#)

Oklahoma has opted for the more traditional choice of evenly weighted three-factor apportionment. Notably, it also allows firms with capital investment of more than \$200 million the choice of using double-weighted sales factor apportionment.

Courts have granted states substantial leeway in adopting competing approaches to apportionment, provided that the chosen approach meets two main criteria. First, the apportionment decision must have some rational relationship to the company's activity in the state—a very permissive standard. Second, the apportionment must be internally consistent. In other words, if every state chose the same given apportionment formula, no more than 100 percent of a corporation's income would be taxed. This criterion stands even if in practice the interaction of competing standards yields double taxation.[\[12\]](#)

The problem of taxing more than 100 percent of income has vexed taxpayers and practitioners, but states have often perceived a different problem: the possibility of taxing less than 100 percent of a corporation's business income.

For states to levy taxes on a company, there must be a sufficient connection—termed “nexus”—between the state and the company's economic activities. The chief limitation on state nexus is Public Law 86-272. This federal law prohibits states from taxing income arising from the sale of tangible property into the state by a company whose only activity in that state is the (remote) solicitation of sales. In other words, if a company maintains a warehouse in the state or even just a kiosk; if it has a sales office, or even just a traveling salesman; if it so much as delivers one of its products into the state with its own employees or in its own vehicle— if any of these factors are present, the company has nexus with the state and is taxable according to the state's apportionment formula. If, however, any marketing is produced in another state, the sales office records the transactions in another state, and products are shipped to customers via a common carrier, it does not matter whether the sales into that state are 1 percent or 100 percent of the company's revenues. By law, that sales income is not taxable in the destination state, because the contacts with the state are insufficient under federal law to establish nexus.[\[13\]](#)

Companies stand to benefit if they can avoid any economic activity other than the remote solicitation of sales into a state. This decision is made at the margin as many other factors influence the decision of where to locate facilities and employees. In fact, many larger businesses are resigned to the fact that they will have nexus almost everywhere. Indeed, many business models are structurally unsuited to avoiding the establishment of nexus in states where they have sales. Still, some companies have flexibility in where they produce and where they sell. These can benefit from locating their production in a single sales factor or low corporate income tax state all the while selling into states which lack the jurisdiction to tax them. This is where throwback rules come into play.

## **What Is a Throwback Rule?**

The average citizen's intuition in defining a throwback rule was not far off. In states where firms have no nexus for taxation, either because of apportionment rules or lack of jurisdiction, a firm's sales to that state result in “nowhere income.” Throwback rules are designed to reclaim “nowhere income,” from a state that has no legal authority to tax it and give that income back to a state with jurisdiction over the taxpayer. Under a throwback rule, sales of tangible personal property are figuratively “thrown back” across state lines and incorporated into the numerator of the origin state's sales factor—even though the state would not otherwise be able to claim that income.

## How Throwback Rules Work

Although some states have adopted their own language, the standard throwback rule establishes uniform language promulgated as part of the Multistate Tax Compact,<sup>[14]</sup> which imposes two requirements. First, the taxing state must be the location from which the tangible property was shipped. Second, the income cannot be taxable in the state of the purchaser, either because the purchaser was the federal government or because the destination state lacks jurisdiction to levy a tax.

Importantly, throwback rules do not apply in cases where a state voluntarily chose not to tax corporate income. Throwback rules ask whether the corporation is taxable in the destination state, not whether it was taxed. (Sometimes, policymakers in states without a corporate income tax, or which provide incentives which zero out some corporations' tax liability, express concern that the revenue they forgo is being swept up by another state's throwback rules. They need not worry.)

A company's income from one state cannot be thrown back to another if the firm can demonstrate that the good was subject to a net income, franchise, or capital stock tax in the destination state, or if that state possessed jurisdiction to levy a tax on the company but opted not to impose corporate taxes.

The list of applicable taxes in destination states is not exhaustive, and that is by design. A company immunized against destination state taxation under P.L. 86-272 cannot avoid throwback by exposing itself to some minimal business fee or tax in the destination state or making a voluntary payment; the tax must be a corporate income tax or a state's alternative to one.<sup>[15]</sup>

**Table 1. States with Throwback and Throwout Rules for Sales of Tangible Property**

State	Throwback	Throwout	State	Throwback	Throwout
Alaska	✓		Mississippi	✓	
Arkansas	✓		Montana	✓	
California	✓		New Hampshire	✓	
Colorado	✓		New Mexico	✓	
District of Columbia	✓		North Dakota	✓	
Hawaii	✓		Oklahoma	✓	
Idaho	✓		Oregon	✓	✓
Illinois	✓		Utah	✓	
Kansas	✓		Vermont	✓	
Maine		✓	Wisconsin	✓	
Massachusetts	✓				

*As of January 1, 2024*

## Competitive and Economic Effects of Throwback Rules

While throwback rules were created to avoid the perceived under-taxation of corporate income, they can lead to double taxation and frequently impose tax burdens high enough to make the state unattractive for businesses.

In terms of attracting corporations to the Sooner State, Oklahoma is at a slight comparative disadvantage in that it does not rely on sales alone for its apportionment formula. Single sales factor apportionment has the effect of exporting part of the corporate income tax burden to out-of-state firms. The introduction of a throwback rule further erodes the competitive advantage otherwise held by in-state firms.

Whatever revenue Oklahoma generates from the throwback rule will most likely be offset by lost revenue as a result of firms' relocations—the natural response to uncompetitive tax rates and apportionment rules. The throwback rule increases a firm's in-state income by the sum of the firm's "nowhere income." Therefore, the sales factor ratio necessarily increases. Paradoxically, the more a throwback rule increases a firm's sales factor, the larger a company's effective tax rate, and the less relevant the state's corporate income tax rate becomes.<sup>[16]</sup> Effective rates on the income actually generated in-state can become so high as to make certain types of business activity nonviable in states with such rules, and over time, businesses have adjusted to this reality. The economic literature suggests that this self-sorting is so prevalent that, even though the throwback rule raises revenue from businesses which have not acted to avoid it, the rule may lose revenue in the long run due to activity driven out of state which would otherwise be subject to the full range of state taxes.

In terms of simplicity, Oklahoma's corporate tax code does offer a silver lining. Unlike many states, Oklahoma requires separate reporting for unitary groups. This means that each company in a related group of corporations (parent companies, subsidiaries, and affiliates) files a separate tax return. Alternatively, many states opt for combined reporting where all related corporations file as a unitary group. Thanks to the separate reporting policy, Oklahoma avoids the added complexity that occurs when the challenges of throwback rules are exacerbated by combined reporting.

## The Inequity of Throwback Rules

Four arguments speak to the inequity of throwback rules. First, the logic of the throwback rule suggests that an origination state has the right to tax income properly associated with another state simply because the other state is unable to tax the income itself. Proponents hold up throwback rules as a means of righting the perceived wrong of anything less than 100 percent taxability of business income. Opponents, for their part, tend to see the rule as "levying the wrong tax at the wrong rate in the wrong state."<sup>[17]</sup> That a business has untaxed activity in one state is not, of itself, a clear reason why an outside jurisdiction should tax that activity.<sup>[18]</sup>

Second, the degree to which many businesses can avoid the consequences of throwback rules undermines the equity argument. The rules ultimately become a tax on a relatively small number of businesses that lack avoidance opportunities. Moreover, states' equity concerns tend to be one-sided and preoccupied only with under-collection, not over-collection. For instance, there has been notably less handwringing from states since the courts have permitted a pastiche of mismatched apportionment formulas and rules which can lead to double taxation. In the words of one scholar, "Why should 'nowhere income' be any more unpalatable than the over-taxation or 'imaginary income' that results for some taxpayers?"<sup>[19]</sup>



Third, the result of throwback rules is not neutral taxation, since any income “thrown back” is taxed at the origination state’s rate, not the rate of the destination state which is unable to tax it. Companies with little ability or inclination to design their corporate structure around the tax code will face uncommonly high tax burdens, while other businesses may locate their sales activities in non-throwback states.[\[20\]](#)

Finally, throwback rules undermine the theoretical justification for making sales a factor in formulary apportionment in the first place. State authority to tax is premised on some connection between the activities of the taxpayer and either the costs they impose on the state or the benefits they receive from the state (though this requirement is construed broadly). There can be little doubt that companies benefit from the governance of states in which they have payroll or property. The justification for apportioning partly or entirely based on sales, however, has historically been that companies benefit from access to a marketplace for which the state is in some ways responsible. For a throwback state to tax income from outbound sales is in some respects a repudiation of that theory. It operates as if the other state conferred no benefits whatsoever and thereby left the tax revenue for the originating state to claim.[\[21\]](#)

## Repealing the Throwback Rule

As a rule, tax cuts do not pay for themselves. Throwback rules, however, may very well be the exception. Since Oklahoma is on solid financial footing following the coronavirus pandemic, the state is well-positioned to cover any short-term transition costs associated with the repeal of its throwback rule. In the longer term, repeal will increase Oklahoma’s ability to attract and retain businesses, thereby expanding, stabilizing, and promoting greater equity within its corporate [tax base](#).

**Table 2. State Apportionment Formulas**

*As of January 1, 2025*

State	Single Sales	Sales Weighted	Three-Factor
Alabama	✓		
Alaska*			✓
Arizona*	✓		
Arkansas	✓		
California	✓		
Colorado	✓		
Connecticut	✓		
Delaware	✓		
Florida**		✓	✓
Georgia	✓		
Hawaii			✓
Idaho	✓		
Illinois	✓		
Indiana	✓		
Iowa	✓		
Kansas			✓
Kentucky	✓		

State	Single Sales	Sales Weighted	Three-Factor
Louisiana*	✓		
Maine	✓		
Maryland	✓		
Massachusetts	✓		
Michigan	✓		
Minnesota	✓		
Mississippi	✓		
Missouri	✓		
Montana	✓		
Nebraska	✓		
New Hampshire*	✓		
New Jersey	✓		
New Mexico			✓
New York	✓		
North Carolina	✓		
North Dakota			✓
Oklahoma			✓
Oregon	✓		
Pennsylvania	✓		
Rhode Island	✓		
South Carolina	✓		
Tennessee**		✓	✓
Utah*	✓		
Vermont	✓		
Virginia**		✓	✓
West Virginia	✓		
Wisconsin	✓		

\* =State has a choice of apportionment formula or different formulae for different industries. Primary apportionment formula shown

\*\* = State has weighted sales in addition to its apportionment factor.

Source: Bloomberg Tax.

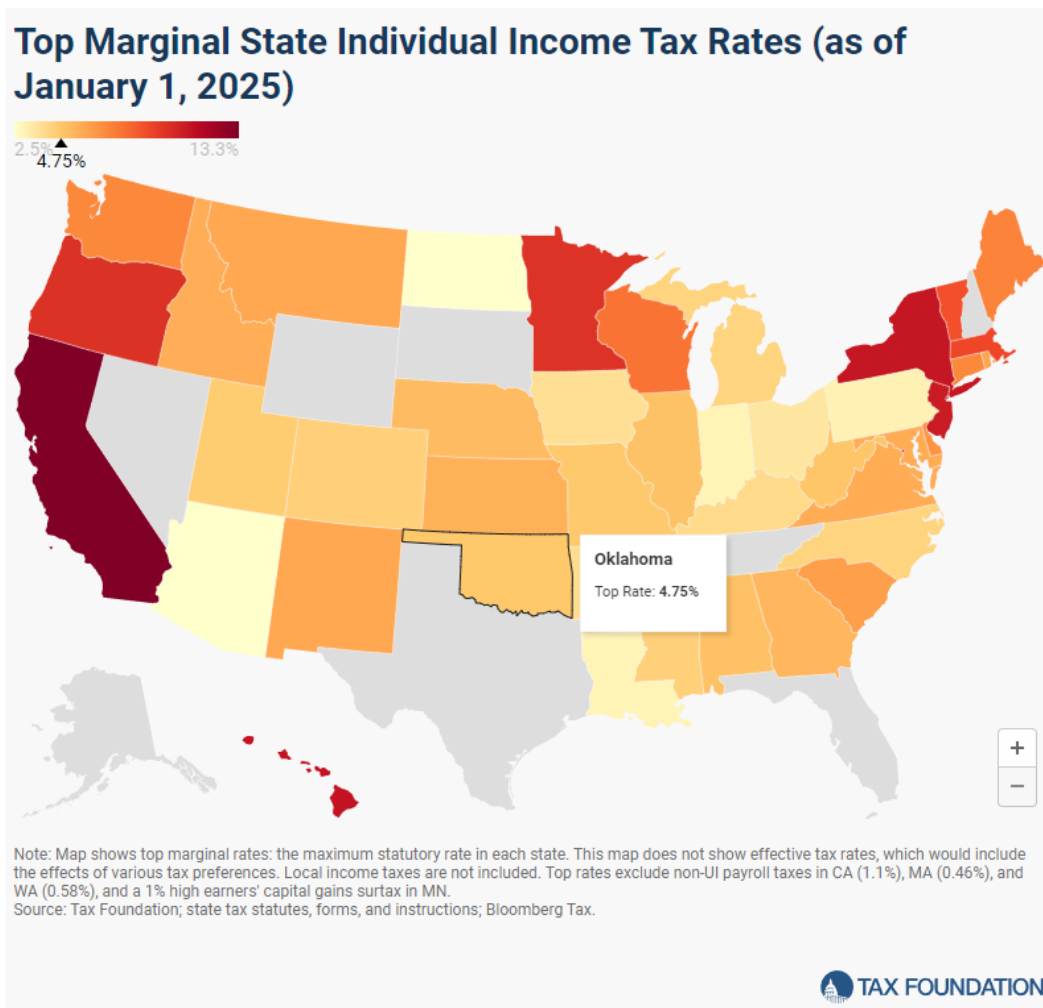
The best argument for including payroll and property in the apportionment formula is that these factors capture the actual business activities which impose costs on government and are a proxy for the services those businesses receive. While the sales factor is justified on the grounds that companies exploit a state's market and rely on government to ensure conditions conducive to commerce, this connection is much more nebulous than the idea that companies derive benefit from government services where, say, their offices and factories are located.

By taxing based on these factors, however, Oklahoma bases corporate income tax liability, in substantial degree, on a company's footprint in the state. Single sales factor apportionment, by contrast, is based exclusively on sales activity into the state, without regard to the location of the company's productive activity. This succeeds in exporting a significant portion of the tax burden to out-of-state companies, which many state policymakers like, but it also avoids "punishing" businesses for choosing to locate their facilities in-state.

One complicating factor for Oklahoma is its extractive industries. Oklahoma raises considerably less than it could from out-of-state businesses, but more than it would otherwise from its in-state businesses—including oil, gas, and mining operations which cannot easily leave the state. Policymakers would have to evaluate the trade-offs associated with shifting to single sales factor apportionment, but if it could be done without sacrificing revenue (as has been the case in many states), it would help reduce the corporate income tax’s discouraging effect on in-state operations.

## Individual Income Tax

Oklahoma’s individual income tax is a six-bracket graduated-rate tax which will feature a top rate of 4.75 percent, the result of rate reductions effective in 2022. This is a competitive rate, though Oklahoma faces stiff competition from neighboring Texas, which does not levy an individual income tax. The current system also imposes a marriage penalty, where married couples filing jointly face a modestly higher tax burden than if each filed separately. Cognizant of the competitive edge associated with lower—or no—individual income taxes, reforming or even eliminating the income tax has been a significant theme in Oklahoma public policy circles.



## The Economic Implications of Income Taxes

### Migration and National Trends

Nine states forgo broad-based individual income taxes, including neighboring Texas, which has seen its economy grow almost 35 percent faster than Oklahoma's over the past two decades. In real (inflation-adjusted) terms, Texas's gross state product soared almost 88.72 percent between 2004 and 2023, while Oklahoma's economy increased a much more modest 54.47 percent, only slightly above the national average of 46.74 percent growth for the period. Gross state product is 33.94 percent higher per capita in Texas than in Oklahoma, and personal incomes are 51.72 percent higher.

Texas is not an outlier in this regard. Recent history demonstrates states which forgo income taxes have seen their populations grow at marginally more (22.09 percent) than the national rate of 15.09 percent, and gross state product grew 13.77 percent faster in states without an income tax than it did in those with one over that period. In 2021 (the most recent year for which data are available), the 41 income tax states lost a net of 925,134 residents to the nine states without an income tax.<sup>[22]</sup> Oklahoma's population has grown a modest 15.41 percent over the past two decades, less than one-third the national growth rate of 15.09 percent, while Texas's population has burgeoned by 37.4 percent, well over twice the national rate. While income tax policy is hardly the only driver of economic activity in these states, it is little wonder that the Texas model—and that of other no- or low-income tax states—is highly attractive. And, in the case of Texas, population growth is occurring despite a relatively high [property tax](#) burden, especially compared to that of Oklahoma.

Oklahoma was among the 21 states cutting either their top or flat individual income tax rates in recent years, doing so from a place of moderate general fund revenue growth. Louisiana and Montana were, by far, the two states with the largest (double-digit) general fund revenue growth between FY 2021 and FY 2024. The remaining 19 states had an average revenue growth of 5.42 percent. This implies that Oklahoma was near the middle of the pack in terms of states which chose to cut individual income tax rates since it had an average growth rate of 5.96 percent during the same time period. From FY 2019 – FY 2021, seven of the 10 states which cut individual income taxes did so from double-digit biennial general revenue fund growth. More recently, states have been content with lower growth—but notably, every state which cut income tax top rates since 2021 still has higher (inflation-adjusted) tax revenue now than before the 2021 round of rate cutting began, even if sometimes only modestly.

Oklahoma's income tax cut was modest, shaving a quarter of a percentage point off the state's individual income tax rates starting in 2022, but it was also adopted amid economic growth that was slower than that experienced in some peer states.

Nearby, through a November 2024 special session, Louisiana enacted sweeping reform which included moving to flat rates for both individual, 3 percent, and corporate income, 5.5 percent, taxes. The state is attempting to stem the flow of out-migration by harnessing sound tax policy to attract and retain residents and businesses. Now, more than ever, Oklahoma faces significant regional competition outside of traditional rival Texas, and tax reform should become an even more urgent priority.

Taxes are far from the only factor that influences location decision-making, but with job availability likely to become less salient as remote work arrangements increase in popularity, they are an important factor, and just as importantly, they are a factor that policymakers can control.

### Table 3. States Cut Individual Income Taxes from Revenue Growth

General Fund Tax Revenue Growth Between FY 2021 and FY 2024

State	Growth
Arizona	0.72%
Arkansas	0.45%
Colorado	4.43%
Georgia	8.82%
Idaho	5.42%
Indiana	3.53%
Iowa	6.54%
Kentucky	6.81%
Louisiana	30.18%
Michigan	7.89%
Mississippi	3.94%
Missouri	6.27%
Montana	52.74%
Nebraska	6.40%
New Hampshire	5.14%
North Carolina	5.60%
North Dakota	7.57%
Ohio	3.66%
Oklahoma	5.96%
South Carolina	7.60%
Utah	8.73%
West Virginia	5.41%

Source: State revenue agencies, Tax Foundation research

### Comparison with Consumption Taxes

All taxes are not created equal. Any tax creates a certain amount of economic drag; this is unavoidable. There is truth to the adage that “whatever you tax, you get less of”—so it makes sense for policymakers to think carefully about what they choose to tax, and how. Individual income taxes fall on labor; on the margin, they lower the payoff to work, decreasing the supply of labor while increasing its cost.

An income tax can be conceptualized as a tax on consumption plus the change in savings, while a well-structured [sales tax](#) is a tax on income less the change in savings (that is, on both the income spent now and on income saved to be spent in the future). An income tax reduces capacity for future consumption; economically, it acts like a sales tax that increases the cost of future consumption, with each additional hour of labor producing fewer goods in the future. Functionally, what this means is that income taxes penalize savings, while consumption taxes do not. Consumption taxes are much more economically neutral by comparison, and the economic literature consistently finds that sales taxes are less of an impediment to economic growth or location decisions than are income taxes.<sup>[23]</sup>

Consumption taxes do fall on suppliers of labor and capital, like income taxes, but they do so neutrally and—at least when well-designed—avoid double-taxing these factors. (Oklahoma, like all states, taxes some intermediate transactions in its sales tax, creating [tax pyramiding](#) and diverging from the model of a pure [consumption tax](#).) Oklahoma’s sales tax is, appropriately, destination-sourced, meaning that the tax is imposed where a good or service is consumed, not where it is produced. Thus, unlike income taxes, the

sales tax does not discourage investment or job creation.<sup>[24]</sup> This is, however, only true insofar as the tax falls on final consumption; when the tax falls on business inputs, it increases the cost of investing in-state.

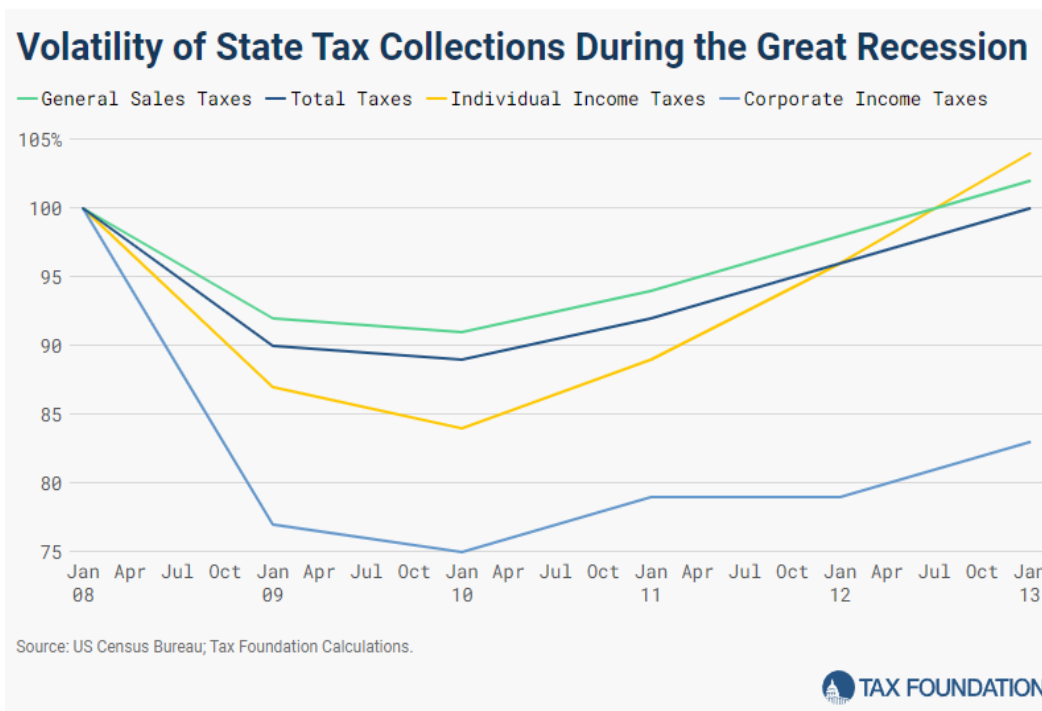
Evidence of the adverse impact of individual income taxes has been documented at the local, state, federal, and even international level. In a series of Organisation for Economic Co-operation and Development (OECD) working papers, OECD-affiliated economists concluded that corporate income taxes are the most harmful to growth, followed by individual income taxes, while consumption and property taxes are less economically damaging. They found that a 1 percent shift of tax revenues from income taxes to consumption and property taxes would increase gross domestic product per capita by as much as 1 percent in the long run, and that income taxes were more strongly associated with lower incomes than were sales or consumption taxes.<sup>[25]</sup> A Canadian study, meanwhile, found that increases in sales taxes are generally associated with increases in economic growth, because they often replace income taxes and other taxes on investment.<sup>[26]</sup>



One interesting local tax study concluded that a 1 percentage point increase in a state individual income tax rate reduces annual population growth rates by 0.81 percentage points, while a similar 1 percentage point increase in local sales tax rates actually increases the annual growth rate by 0.83 percent.<sup>[27]</sup> evidently because residents favor the services provided by sales taxes more than they dislike the tax, whereas the opposite is true for local income taxes. The study's authors also speculated that residents considered the sales tax to be more exportable, though the degree to which this is true may be greater for a locality than it is for a state.

Because a well-structured sales tax is more economically efficient than income taxes, using revenue from sales tax rate increases to pay down income tax rate reductions is economically competitive, as is generating revenue for the same purpose from sales tax [base broadening](#), provided that the base is broadened to previously untaxed final consumption and not to intermediate transactions.

Sales taxes also offer greater stability than income taxes, as can be seen in aggregate state tax collections during and immediately after the Great [Recession](#). By 2010, general sales taxes were down 8 percent from their 2008 peak, while individual income taxes fell 16 percent and corporate income tax collections plummeted a full 25 percent.<sup>[28]</sup> In Oklahoma in 2010, individual income tax collections were down 20 percent and corporate income tax receipts slipped 40 percent, while sales tax collections only declined 6 percent.<sup>[29]</sup>



The relative stability of sales taxes compared to income taxes was not unique to the Great Recession, and indeed, it makes logical sense. While most of us curtail some expenditures during an economic downturn, there is only so much we can—or are willing to—cut. Even those with no wage income continue to consume, supported by savings and governmental assistance, while those whose incomes decline are likely to reduce savings rates more drastically than consumption. Corporate income tax collections are the most volatile because, even in a deep recession, most individuals earn taxable income, whereas corporations may post actual losses and thus have no net income to tax.

Both income and consumption fall when the economy contracts, but not in tandem, with personal expenditures representing a greater share of income during a downturn. The coronavirus pandemic was the exception that proved the rule, however: sales tax collections were indeed stable, with revenues growing at a steady pace after an initial dip during stay-at-home orders. Rather than declining, however, income tax collections actually rose as fast or even faster than sales tax collections in many states, thanks to generous income infusions from the federal government which drove personal income to all-time highs. In the absence of such extraordinary intervention, consumption taxes provide a better buffer against the vicissitudes of the business cycle.

### **Impact on Pass-Through Businesses**

Over 96 percent of all Oklahoma businesses are what is known as pass-through businesses, meaning that business income is taxed on (“passes through to”) the individual income tax returns of the owner or owners, rather than being taxed at the entity level like a traditional C corporation.<sup>[30]</sup> Pass-through businesses are often thought of as small businesses, but this is not entirely true. Most pass-through businesses are small businesses, but for that matter, most C corporations are as well. Over 99 percent of Oklahoma businesses meet the US Small Business Administration’s definition of a small business, and small businesses—the vast majority of which pay through the individual income tax—employ 51.1 percent of the state’s workforce.<sup>[31]</sup>

The individual income tax is therefore extremely important to businesses, because it is the tax that most businesses pay. And while the roughly 15,000 C corporations subject to the state’s corporate income tax<sup>[32]</sup> are also exceedingly important to the state’s economy, and punch substantially above their weight in share of the workforce, many of their suppliers and clients are subject to the individual income tax, so they too have a stake in lower individual income taxes.

### **Impact on Migration and Remote Work**

Tulsa made waves as one of the first cities to offer a generous “move-in package” to attract newly mobile workers, extending \$10,000 in cash and free access to coworking facilities to entice employees of out-of-state businesses who now have remote work flexibility. The Tulsa Remote program began before the pandemic, but its salience dramatically increased as remote work became increasingly possible because of—and extending beyond—the pandemic.<sup>[33]</sup> Such programs are not particularly scalable on a state level, and their local benefits have more to do with the marketing effect of growing a city’s brand and name recognition than they do in directly attracting residents through the incentive. However, local officials in Tulsa identified a very real phenomenon: a growing share of the workforce can now live anywhere with a high-speed internet connection, regardless of their employer’s location.

Traditionally, employees have been tied to specific geographies. When almost all work is performed in physical offices, an employer engaged in locational decision-making must find an equilibrium representing the optimal balance of a variety of often competing factors. They must balance costs of doing business (tax burdens, operating costs, regulatory costs, and labor costs) with access to a qualified workforce and quality of life considerations (schools, research universities, transportation systems, housing markets, cultural amenities) that are important to both executives and the workforce they want to attract. Depending on their business model, they may also need to be located close to clients, suppliers, or their customer base.

Simplify the decision, for a moment, to a question of attracting a qualified workforce. Certainly there are plenty of companies that could locate in Tulsa or Oklahoma City, and which the state of Oklahoma would love to attract to those locations. Tax policy is one way to bring in these employers. But for every business that is located elsewhere, there may still be some employees who would prefer to live in Oklahoma. Previously, that option was not available to them. The workforce balance that is optimal overall is never optimal for each individual. Some employees will gladly pay a premium for what more expensive cities have to offer, while others take little or no advantage of their amenities—even though they are paying for them through taxes and a high cost of living—and would far prefer a different arrangement. Traditionally, however, individual preferences are in tension with each other: a person may not appreciate any of the amenities they are paying for but appreciate working in a field which recruits heavily from people who do.

The rise of remote work changes the equation. To the extent that teams can operate virtually, employees can decide for themselves which bundle of amenities—priced in both cost of living and tax burdens—contribute to their quality of life and which do not, and choose where to live accordingly, knowing that their job will follow them there. Not everyone who takes advantage of this flexibility will do so in pursuit of financial savings. A highly compensated employee might abandon one high-cost, high-tax jurisdiction for another similarly costly locale because she prefers living in a resort destination to a major metropolitan area. Others, however, will move for lower taxes, a lower cost of living, or a higher (to them) quality of life—things that will often go together.

Oklahoma’s great challenge, of course, is its border with Texas, which forgoes an individual income tax. But Oklahoma does not need to go to zero to enhance its competitive standing. High property taxes are one of the trade-offs in Texas, where the effective tax rate on owner-occupied housing is almost twice Oklahoma’s rates (1.6 percent compared to 0.83 percent of market value).<sup>[34]</sup> With sufficiently low-rate income taxes, Oklahoma could be a highly attractive location for remote workers who care about low tax costs and a modest cost of living.

## Reform Options

With a top rate of 4.75 percent, Oklahoma has the seventh-lowest rate among those states levying an individual income tax, and the 16th-lowest overall (counting states with no income tax).

This represents a continuation of efforts, dating to the late 1990s, to make the income tax more competitive, with many leading lawmakers—including multiple governors—articulating a vision of eventually eliminating it entirely. Governor Stitt recently urged lawmakers to enact “a half and a path,” a half point income tax cut and a path to elimination.<sup>[35]</sup>

Many policymakers want to build on these efforts of recent rate reductions. Lawmakers have a number of options in achieving this goal, including: (1) implementing a single-rate income tax, (2) enacting revenue triggers to phase in future rate reductions subject to revenue availability, (3) using sales tax base broadening to pay down income tax rate reductions, or even (4) converting the current income tax into a consumed income tax.

### Implementing a [Flat Tax](#)

Oklahoma currently imposes a six-bracket graduated-rate income tax, but the top rate (4.75 percent as of 2025) kicks in at \$7,200 for single filers and \$12,200 for joint filers. This means

that the overwhelming share of all taxable income is exposed to the top marginal rate. The system is graduated, but the effect is relatively flat. The [standard deduction](#) of \$6,350 (doubled for married filers) is considerably lower than the federal standard deduction (\$15,000 in 2025), though Oklahoma does offer a \$1,000 personal exemption per member of the household, which the federal government does not, and which provides a greater benefit to low-income households than the lower marginal rates. If all income were taxed at the top marginal rate without the benefit of lower brackets, a single taxpayer could face up to \$189 in additional tax liability. However, if there were no standard deduction or personal exemption, a single filer's liability could increase by \$345.

The first five bracket widths are doubled for married couples filing jointly, but the top bracket kicks in at \$12,200 for joint filers—\$2,200 short of doubling the bracket width for single filers. This creates what is known as a marriage penalty, where joint filers have more income exposed to higher marginal rates than if the two were filing separately. That additional taxable income costs up to \$95 in additional tax liability per household, which is not an enormous amount but still represents an inequity, particularly for lower-income households.

Eliminating the marriage penalty should be a goal of policymakers, but it comes at a cost: if the final bracket width were doubled, income tax revenues would decline by about \$55 million. It is, however, possible that the state may eventually wish to absorb this loss to create fairer treatment of married couples, or to incorporate it into broader reforms, including the transition to a flat-rate income tax.

The economic literature on graduated-rate income taxes is unfavorable, since economic decision-making takes place on the margin—in this case, with regard to the top marginal rate, which is the relevant rate for most Oklahoma taxpayers, and for nearly all [pass-through business](#) activity. Furthermore, while recent rounds of rate reductions have yielded moderate rates, graduated-rate income taxes tend to be far easier to raise. When most or all taxpayers share in a tax increase, there is substantial political pressure to balance revenue needs with tax competitiveness. The ability to single out select taxpayers for higher rates—which will also fall on many small businesses—would make future tax increases easier. There are practical and political limits on how high a rate can go when it is applied uniformly, and these do not exist in the absence of a flat rate.

Fourteen states now have a flat rate income tax with six states adopting a flat rate between 2021 and 2024. North Carolina's rate of 4.5 percent is the highest flat rate in the country. States like [Illinois](#) (4.95 percent) and [Pennsylvania](#) (3.07 percent), not known for a commitment to low taxes, have maintained low rates largely because of their flat-rate structure. Indeed, when Illinois lawmakers have sought to amend the state constitution to allow a graduated-rate tax, they have paired it with proposals that would, in some cases, yield double-digit top marginal rates. And whereas only [Georgia](#) has a flat tax with a rate higher than 5 percent (the state recently went to a flat tax and is in the process of phasing in rate reductions), states with graduated-rate income taxes have top rates as high as 13.3 percent in [California](#), 10.9 percent in [New York](#), 10.75 percent in New Jersey and the [District of Columbia](#), 9.9 percent in [Oregon](#), and 9.85 percent in [Minnesota](#).<sup>[36]</sup> While Oklahoma would never adopt California-style rates, a flat-rate system would be an investment in keeping rates competitive for the long term.

Oklahoma could, for instance, adopt a higher standard deduction in exchange for a single-rate income tax. Increasing the standard deduction by \$4,000, to \$10,350, would not only bring the Oklahoma standard deduction closer to the federal one (\$15,000 in 2025) but would also pull off a hat trick: providing tax relief for the lowest-income Oklahomans, ensuring that no one experiences a tax increase, and holding the revenue loss to what is effectively a rounding error.

This approach, moving to a flat-rate income tax with a 4.75 percent rate and a higher standard deduction, would not yield any significant immediate changes in tax liability, but it would help secure competitive rates going forward, providing a defense against high top marginal rates in the future. This competitive advantage could be locked in even more effectively if safeguarded by a constitutional amendment, as other states have. This reform could, of course, be adopted as a standalone policy or combined with revenue offsets or net tax cuts to reduce rates overall, which could make the plan even more attractive.

## **Reducing the Rate with Revenue Triggers**

Oklahoma's experience with revenue triggers was at most a qualified success. The state's efforts to dedicate a share of future revenue growth to tax relief was complicated by a curious design which did a poor job of capturing actual revenue conditions. Properly designed triggers, however, would be a responsible way of returning a portion of future tax revenue growth with taxpayers in the form of lower income rates. This could stand alone or could complement other reforms.

Across the country, revenue triggers have emerged as an effective way to implement or phase in tax rate reductions or other tax reform measures as revenues permit. Tax triggers are a newer take on an old concept: contingent enactment of a legislative provision. States have long relied upon bills with contingent enactment clauses, providing that certain features of new legislation shall only be operative if certain conditions are met. Tax triggers build on this model, making tax reform measures contingent on state revenues meeting or exceeding established targets.[\[37\]](#)

Tax triggers can help ensure revenue stability and limit the uncertainty associated with changes to the tax code while providing an efficient way for states to dedicate some portion of revenue growth to tax relief. Their ability to do so, however, depends on their design. Poorly designed triggers can implement cuts when economic conditions do not warrant it or postpone reductions even when revenue growth would permit it. By contrast, properly constructed tax triggers are a valuable mechanism for providing meaningful rate relief.

Well-designed triggers require selecting a baseline revenue figure—either a given year's revenue or a statutorily-established amount—and then establishing benchmarks that reflect meaningful revenue growth. While this may sound simple, Oklahoma and other states have learned that it is possible to get the benchmarks wrong.

Oklahoma's previous triggers were designed to reduce the top marginal income tax rate from 5.25 percent to 4.85 percent in two stages. Ultimately, the second reduction was not implemented, and officials later lowered rates independently of the trigger. Notably, these triggers were based on year-over-year general fund balance projections, with each of the two stages of planned rate reductions implemented if thresholds were met. This approach had at least three shortcomings.

First, by focusing on single year revenue changes, Oklahoma opened itself up to the possibility of a downward ratchet effect, where recovery from a year of revenue decline could trigger a tax cut even if revenue levels are stagnant or even down over a longer time frame. For a variety of reasons, the COVID-19 pandemic did not yield the revenue losses many anticipated. Imagine, however, if revenues had slipped 5 percent rather than rising by a similar amount. If, the following year, revenues merely recovered to pre-pandemic levels, this would appear to be meaningful growth on a year-over-year basis, when it actually represents a revenue decline in real (inflation-adjusted) terms from a pre-pandemic baseline.



Second, it relied on projections rather than actual revenues. This was intended to make the triggers more forward-looking and aligned with the budget process, but the result was to divorce the process from real-world collections, merely looking at the change from one year's projection to the next. Use the pandemic as an example once again. In the spring of 2020, state forecasts for the coming fiscal year were extremely pessimistic. In the spring of 2021, by contrast, most forecasts for FY 2022 were decidedly rosier. While revenues in FY 2022 are likely to be higher than FY 2021, comparing the two forecasts would yield a much sharper growth trajectory than would looking back at actual collections for each fiscal year.

And third, it was potentially subject to gamesmanship because it incorporated a fund balance component under which lawmakers could pre-authorize expenditures or divert funds to postpone otherwise scheduled tax cuts even in good years.[\[38\]](#)

Oklahoma can and should look at revenue triggers again, but with an emphasis on best practices. Instead of using year-over-year revenue changes, policymakers should establish a specific revenue baseline and employ benchmarks that measure real revenue growth, adjusted for inflation, over that base year amount. Ideally, reductions should not be tied to specific years, but instead triggered whenever real revenue growth is adequate to reduce rates by at least a given increment—say 10 or 25 basis points—with the actual size of the reduction based on a statutorily-established proportion of inflation-adjusted revenue growth.

There may, of course, also come a time when lawmakers determine that they have adequate revenues to implement an immediate tax rate reduction. Under a flat-rate tax with a \$10,350 standard deduction, each percentage point of rate reductions would cost an estimated \$875 million in current dollars, meaning that, for instance, adopting a flat 4 percent rate would forgo just under \$660 million in lost revenue. Under the current graduated rate system with a lower standard deduction, an across-the-board rate reduction of one percentage point would cost just over \$830 million.

### **Paying Down Rate Reductions with Sales Tax Modernization**

With each passing year, Oklahoma's sales tax becomes less representative of the state's economy. Sales tax bases across the country are eroding as consumer spending patterns shift, so modernizing the sales tax base can generate revenue for income tax rate relief. Done properly, this is a win for taxpayers, as it reduces reliance on an uncompetitive tax by raising more money from a less damaging one, while creating a more neutral—and thus less inefficient—tax base for the sales tax by eliminating economically unsound carveouts and exclusions. Policymakers should, however, avoid the temptation to chase a rate—or the elimination of the individual income tax—if it means making unsound choices about base broadening. Highly significant reforms are possible even on an incremental basis.

A responsible expansion of the sales tax base, as enumerated elsewhere in this publication, could yield a 3 percent top marginal income tax rate without adjusting current sales tax rates. Further cuts could be achieved using a combination of base broadening and rate increases.

However, while reducing income tax burdens by shifting further toward consumption taxes is not only viable but desirable, full repeal of the individual income tax through a broader sales tax base, higher rates, or both would yield potentially unpalatable sales tax rates. Expanding to a broad, but still attainable, range of currently untaxed goods and services—outlined in the discussion of sales tax reform options—would generate about \$732 million, enough to pay for an across-the-board rate reduction yielding a new top rate of about 3.87 percent.

If, moreover, local sales tax rates could be adjusted to make local collections revenue neutral on the new base, base broadening could pay for about a 2.3 percent top marginal income tax rate while aggregate sales tax rates remain identical—a higher state rate, but lower local rates, commensurate with the broader base on which revenue can be raised.

This is highly competitive, since the only seven states with income tax rates below 4 percent are [Arizona](#) (2.5 percent), [Arkansas](#) (3.9 percent), [Indiana](#) (3 percent), Louisiana (3 percent), [North Dakota](#) (2.5 percent), [Ohio](#) (3.5 percent), and Pennsylvania (3.07 percent), among the 41 states that impose wage income taxes.

But to zero out the income tax using this broader base, the state sales tax rate would have to increase substantially, from 4.5 percent now to about 8.3 percent. While an 8.3 percent state sales tax rate is high, it can be competitive in the proper environment—but less so in Oklahoma, where it would be combined with local option sales taxes which are quite high in their own right. Even with a broader base, Oklahomans would be looking at a combined average state and local sales tax rate of 10.8 percent to fully offset the elimination of the individual income tax if local sales tax rates were adjusted to reflect the expanded base, and 11.8 percent if they were not. The latter rate, in particular, is likely to be considered prohibitively high. Such a rate would likely induce additional cross border sales, and businesses which face sales taxes on their business-to-business transactions would be at a competitive disadvantage compared to their out-of-state peers.

If, instead, the sales tax base were broadened to include nearly all final consumer transactions—including things like health care and education, to the extent that they are legally taxable under federal law and regulations—the new combined sales tax rate would be about 11.8 percent (or 10.8 percent without a local adjustment), similar to the current (temporary) high of 10.12 percent in Louisiana and on a much broader base. And replacing the income tax with higher sales tax rates alone, in the absence of any base broadening, would require an entirely unrealistic all-in rate of 13.9 percent.

A prior effort to broaden the sales tax base to pay down reforms elsewhere gained little traction, with former Gov. Mary Fallin (R) proposing expansions that relied heavily on the taxation of intermediate transactions,<sup>[39]</sup> leading to tax pyramiding that would undercut the competitiveness of in-state businesses and lead to Oklahomans—particularly lower- and middle-income Oklahomans—paying the same tax several times over in some of their purchases.

It is crucial that policymakers avoid this mistake in considering sales tax base broadening as a way to pay down income tax rate reductions. There are responsible ways to broaden the base—but lawmakers should avoid the temptation of seeing every sales [tax exemption](#) as a potential revenue-raiser. Some exemptions are structurally necessary to avoid tax pyramiding. The ideal base is final consumption, so the exclusion of business inputs should not be deemed a carveout; it is, rather, consistent with the definition of consumption taxation.

Instead of the distraction of trying to identify sales tax base-broadening options to eliminate the income tax, policymakers could prioritize a more incremental—but still highly significant—reform, using sales tax base broadening to facilitate an across-the-board income tax cut, building on reforms adopted in 2021 to make Oklahoma’s income tax rates among the lowest in the country. The sales tax base-broadening options to pay for these reductions are delineated in our discussion of sales tax reforms.

The following table assumes that the full set of reasonable expansions to the sales tax base laid out in our discussion of the sales tax are adopted and looks at the revenue-neutral sales

tax rate necessary to implement across-the-board rate reductions bringing the top income tax rate to 4 percent, 3 percent, 2 percent, and 1 percent, or to repeal it entirely. The sales tax rates necessary to achieve these targets using the current base are also included, starting from the current average combined state and local sales tax rate of about 9.01 percent. Finally, this analysis assumes that local option sales tax rates are proportionally reduced to make base broadening revenue neutral at the local level (options for doing so are discussed elsewhere), but a separate line is provided using the assumption that local sales tax rates remain the same, yielding increased revenue for localities.

**Table 4. Sales Tax Rates to Achieve Income Tax Reduction Targets**

Assumption	Current	Income Tax Top Marginal Rate Target				
		4%	3%	2%	1%	0%
Current Sales Tax Base	9.0%	9.8%	10.8%	11.8%	12.9%	13.9%
<b>Modernized Sales Tax Base</b>						
— without local adjustment	8.0%	8.6%	9.4%	10.2%	11.0%	11.8%
— with local adjustment	7.0%	7.6%	8.4%	9.2%	10.0%	10.8%

*Sources: US Bureau of Economic Analysis; Tax Foundation calculations.*

Notably, Oklahoma could achieve a top individual income tax rate of 3 percent without any change in sales tax rates if it right-sized its sales tax base as recommended elsewhere in our analysis.

### Adopting Nonresident Filing and [Withholding](#) Exemptions

Oklahoma’s current treatment of nonresident earned income could be improved by implementing low-cost, simplifying reforms to its employee filing and employer withholding thresholds.

At present, Oklahoma requires nonresident individuals who earn \$1,000 or more in any calendar year from Oklahoma sources to file a state income tax return. Employers must withhold state income tax if a nonresident employee earns over \$300 in a calendar quarter for services performed within Oklahoma. The state’s neighbors aren’t much better, though [New Mexico](#) allows 15 days before employer withholding is required.

Thirteen states, however, offer more generous thresholds—and their number is growing. Thresholds can be denominated in days, in-state earnings, or both, though days in-state is preferable. For instance, Indiana and [West Virginia](#) recently exempted nonresident employees from state income tax filing and withholding requirements if they work in the state for 30 days or less within a calendar year, while Louisiana recently adopted a 25-day threshold. These policies reduce administrative and compliance burdens for taxpayers with little in-state liability.

Adopting a 30-day filing and withholding threshold in Oklahoma could offer several benefits. It would simplify tax compliance for nonresident workers who have only short-term assignments in the state, potentially making Oklahoma a more attractive destination for conferences and for businesses which require occasional in-state travel. It also reduces compliance costs dramatically, and eliminates the administrative burden of processing returns with negligible liability. For many filers who only spend a few days in-state, the cost of filing an additional state return can far exceed the amount owed.

## Creating a Consumed Income Tax

Many economists have championed the idea of a consumed income tax as a replacement for the individual income tax. Such a tax would only apply to income used for consumption, excluding savings and thus eliminating the economic disadvantages inherent in traditional income taxation. An ideal consumed income tax would exclude all saved and invested income from the base until it is withdrawn from savings and used for consumption. This addresses the current income tax's bias against investment and reduces its adverse effect on labor.

An ordinary income tax reduces the return on invested income twice, while reducing the returns to consumption only once, creating a bias against investment and, at the margin, reducing the incentive for work generating income above consumption levels. This issue is compounded by the effects of inflation, since the taxpayer will be taxed on nominal investment returns even if they reflect losses or low returns in real terms. A consumed income tax, by contrast, would not tax income while it is being invested, only when it is spent.

In practice, a state-level consumed income tax would likely require the creation of a state-recognized universal savings account through which taxpayers could save and invest, and where income would be exempt until withdrawn. In this way, it would be much like other tax-advantaged investment vehicles well-known to taxpayers, like IRAs and 401(k)s, except that there would be no contributions limit and no penalty for withdrawals—other than the imposition of tax when income is withdrawn to be spent.

To raise the same amount of revenue as the current income tax, a consumed income tax rate would have to be higher, since it operates on a narrower base. Oklahomans saved roughly \$12.6 billion in 2018,<sup>[40]</sup> suggesting that the revenue neutral rate for a consumed income tax would be about 5.4 percent, compared to the 4.75 percent rate of the current income tax as of 2022. While this rate is higher, the tax base is much more economically efficient, as it does not discriminate against savings and investment the way the current income tax does.

## Sales Taxes

Oklahoma's reliance on the sales tax is slightly higher than average: the state brings in just under a third of its state and local tax collections from the sales tax, while most states rely on sales taxes for just under a quarter of collections. At issue is not the state sales tax, with its modest 4.5 percent rate on a fairly ordinary base, but rather local sales taxes, with rates that often rival the state rate. Sales taxes accounted for only 13.5 percent of local tax collections nationwide in 2022 but made up 40.2 percent of local collections in Oklahoma that same year.

<sup>[41]</sup>

As addressed elsewhere, this heavy reliance on the sales tax can be partially explained by the limited number of local government entities given authority to levy property taxes (called the ad valorem tax in Oklahoma). Additionally, sales tax is an attractive way for localities to raise revenue, because it creates a possibility for some of the tax burden to be outsourced to those who shop across district lines.

This higher reliance is reflected in higher rates. The state-level rate is below average at 4.5 percent, but when combined with local rates, the average Oklahoman faces rates of 9.0 percent, the sixth-highest combined rate in the country. Oklahoma has remained in an unenviable position for many years, only moving from fifth to sixth due to other states increasing their rates, rather than any effort on Oklahoma's part to lower the sales tax burden.

**Table 5. Sales Tax Rates, Oklahoma and Bordering States**

State	State Rate	Average Local Rate	Combined Rate
Oklahoma	4.50%	4.51%	9.01%
Arkansas	6.50%	3.06%	9.56%
Colorado	2.90%	4.15%	7.05%
Kansas	6.50%	2.05%	8.55%
Missouri	4.23%	9.42%	7.16%
New Mexico	5.13%	1.97%	7.09%
Texas	6.25%	1.06%	7.31%

*Source: U.S. Bureau of Economic Analysis; Tax Foundation calculations.*

Neighboring Arkansas does experience a far higher average rate of 9.56 percent, but Oklahoma still surpasses most of its neighbors and compares unfavorably with rates throughout the rest of the country. The limited reach of the property tax plays a major role in these rates, but a modest sales tax base, combined with below-average per capita personal consumption, is at play as well. Modernizing the sales tax base and using revenue from base broadening to pay down income tax rate reductions at the state level and local option sales tax rate reductions at the municipal level, is a compelling way to address this issue.

#### **Oklahoma’s Sales Tax Base Is Narrow and in Need of Modernization**

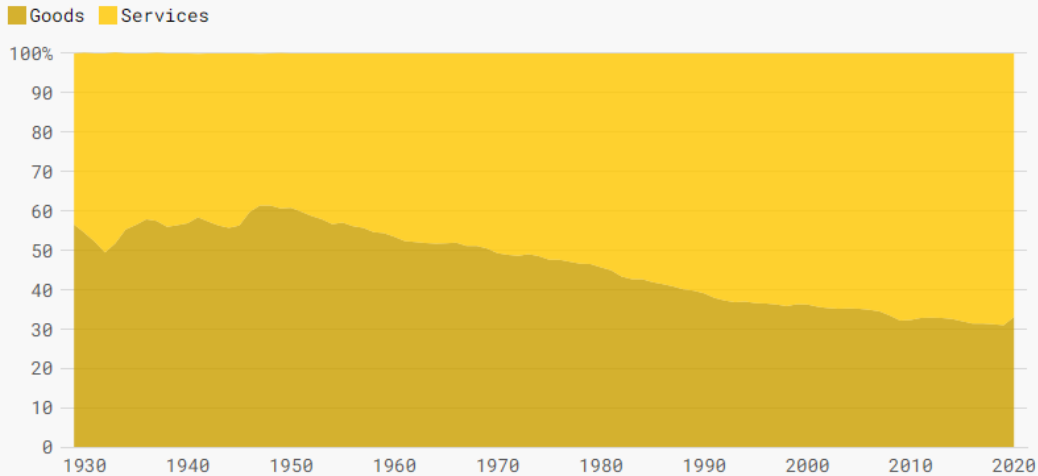
Like most states, Oklahoma imposes its sales tax on a base that consists of most goods and relatively few services. With limited exceptions, the state’s sales tax is imposed on transactions involving tangible property—appliances but not apps, light fixtures but not landscaping. As is often the case, this was less of a conscious choice than an accident of history, a relic of the fact that Oklahoma’s sales tax was first imposed in 1933, at the height of the Great Depression. Services comprised a far smaller share of the economy, and it was administratively simpler in that earlier era to focus almost exclusively on retail sales of goods.

Today’s economy has little in common with that of 1933 or even 1993. Higher incomes and changing consumer tastes have shifted a greater share of consumption to services, while a digital economy is upending traditional categories. Not only does more disposable income go to the consumption of services, but some traditional consumption of goods has been displaced by services and subscriptions.



## Percentage of Total Personal Consumption Expenditures

Goods vs. Services, US, 1927-2017



Source: Bureau of Economic Analysis, Regional Economic Accounts.



Oklahoma’s sales tax base is not as narrow as some of its peer states’ bases, but it remains narrow—and erodes further each year. In 2024, Oklahoma exempted groceries from the state sales tax. While politically popular, such narrowing of the sales tax base makes other reform efforts, like rate reductions, more difficult. Apples-to-apples comparisons of state sales tax bases are difficult, but one method is to calculate the value of taxed transactions as a percentage of personal income. [Hawaii](#), for instance, has a sales tax breadth of 119 percent of state income. [\[42\]](#) The state exempts some transactions which arguably should be taxed, but double-taxes others. Oklahoma also exposes some transactions to multiple levels of taxation but omits far more transactions altogether. The state’s sales tax breadth, as a percentage of state income, is 36 percent.

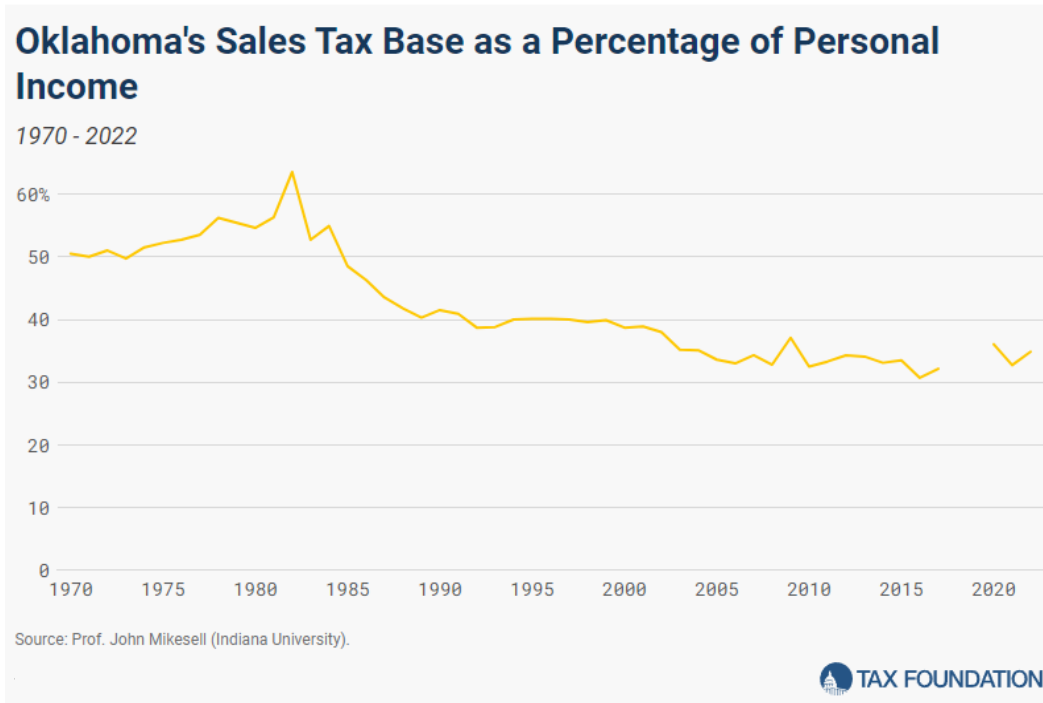
**Table 6. Sales Tax Breadth as a Percentage of Personal Income (FY 2022)**

Source: Tax Foundation Research

State	Breadth
Oklahoma	34%
Arkansas	43%
Colorado	34%
Kansas	34%
Missouri	30%
New Mexico	76%
Texas	43%

A robust sales tax base would not reach 100 percent, as not all income is consumed in any given year, but, per personal consumption data, should be about 73 percent of state income in Oklahoma, suggesting that the state is only reaching half of its sales tax base potential.

The state's sales tax breadth has seen a substantial decline over time. It saw an especially steep drop in the 1980s, reflecting rising incomes, growth of interstate sales, and an accelerating shift toward the consumption of services. Oklahoma has taken action to collect more taxes on online sales, but there is an opportunity to build on that change with broader efforts to stabilize the tax base.



## Oklahoma Should Right-Size its Sales Tax Base

As Oklahoma's sales tax base continues to shrink as a share of total personal consumption, the state has three choices: accept reduced revenue, raise sales tax rates, or shift collections to other taxes. Instead of increasing rates on a narrow base, lawmakers should consider broadening the base itself. Right-sizing the sales tax base would make the tax more neutral in its application, while generating additional state and local revenue that could be used to reduce reliance on more unstable or economically harmful taxes.

In this search for a more modern sales tax base, policymakers should keep in mind several main principles and features of sales taxation that are broadly accepted by public finance scholars and tax policy researchers across the board, namely:

1. An ideal sales tax is imposed on all final consumption, both goods and services;
2. An ideal sales tax exempts all intermediate transactions (business inputs) to avoid tax pyramiding;
3. Sales taxes should be destination-based, meaning that tax is owed in the state and jurisdiction where the good or service is consumed;

4. The sales tax is more economically efficient than many competing forms of taxation, including the income tax, because it only falls on present consumption, not saving or investment;
5. Because lower-income individuals have lower savings rates and consume a greater share of their income, the sales tax can be regressive, though broadening the base to include additional consumer services (much more heavily consumed by higher-income individuals) represents a progressive change;
6. The sales tax scales well with ability to pay, because it grows with consumption and is therefore more discretionary than many other forms of taxation; and
7. Consumption is a more stable tax base than income, though the failure to tax most consumer services is leading to a gradual erosion of sales tax revenues as services become an ever-larger share of consumption.

In practice, policymakers are unlikely to opt for the inclusion of all personal consumption in the sales tax base, since this would include education and health services.<sup>[43]</sup> Failing to make any realignment at all, though, risks a sales tax that no longer reflects sales and consumption in Oklahoma.

### **The Importance of Excluding Business Inputs**

The goal of base broadening is not—or at least should not be—higher revenue, but rather, greater stability. Lawmakers should take care to avoid newly applying the sales tax to goods or services that are primarily purchased as business inputs. By definition, retail sales taxes should apply to final consumer transactions, not intermediate transactions. When intermediate goods and services are exposed to the sales tax, this increases the costs of production. As a result, many of those taxes get passed along to consumers in the form of higher prices, but this disguises the true costs of government, as consumers have no way of knowing how much of the cost of the final good or service is attributable to tax pyramiding.

Whether businesses can pass on these costs depends on the nature of the market in which they operate. Businesses that are regional in their nature will largely pass these costs onto purchasers since the cost is shared by most if not all of their competitors. Those operating within larger markets, however, may absorb the costs themselves if their out-of-state peers are not exposed to similar levels of taxation on their inputs, as they cannot raise prices without putting themselves at a competitive disadvantage. In this way, sales taxes on business inputs also operate as a punitive tax on in-state businesses compared to competitors with production out-of-state.

When a sales tax exposes many business inputs to taxation, the sales tax ends up functioning more like a gross receipts tax, which is among the most economically harmful taxes states levy. The taxation of business inputs inevitably impacts some businesses and industries more heavily than others depending on how heavily a business consumes taxable products and services. The threat of tax pyramiding can distort business decision-making and inefficiently favor some business models—or sizes of operations—over others. For instance, vertically integrated firms—those which keep

more operations in-house—have fewer outside transactions, and thus less exposure to a sales tax that inappropriately taxes a broad range of business inputs. This favors businesses able to keep everything from packaging, warehousing, and distribution to legal, accounting, and marketing in-house, and particularly favors larger firms over smaller businesses which might contract out for certain services.

Imagine, for sake of argument, a manufacturer in Oklahoma City with \$5 million retail sales and \$4.5 million in expenses, earning a healthy profit of \$500,000. Assume that they do their actual manufacturing in-house, but as a relatively small company, they contract out for a range of services, from accounting and legal services to packaging, distribution, and marketing, such that \$580,000 of their \$4.5 million in expenses are business services procured from other firms. We will assume that none of their non-service inputs are subject to the sales tax, though in practice, some may be.

Under a properly structured sales tax, the goods are taxed when sold at retail. At a combined rate of 8.625 percent in Oklahoma City, that would yield \$431,250 on \$5 million in sales. Under a European-style value-added tax, nearly every cost of production (in our example, everything except labor costs) would be taxed, including the final retail sale, but with credits against any previously taxed amount, meaning that only the incremental increase in value is subject to tax. At the same rate, this would also yield \$431,250 in total taxation. If, however, a sales tax which falls on service inputs is applied, then the total tax is \$485,156, an effective sales tax rate of 9.703 percent, compared to the statutory tax rate of 8.625 percent.

**Table 7. How Tax Pyramiding Works with the Taxation of Business Inputs**

Component	Amount	Sales Tax	VAT	Sales Tax with Inputs
Labor	\$2,000,000	\$0	\$172,500	\$0
Property	\$275,000	\$0	\$23,719	\$0
Machinery	\$600,000	\$0	\$51,750	\$0
Energy	\$350,000	\$0	\$30,188	\$0
Raw Materials	\$650,000	\$0	\$56,063	\$0
Packaging	\$60,000	\$0	\$5,175	\$5,175
Distribution	\$100,000	\$0	\$8,625	\$8,625
Legal Services	\$40,000	\$0	\$3,450	\$3,450
Accounting/Auditing/HR	\$75,000	\$0	\$6,469	\$6,469
Marketing	\$300,000	\$0	\$25,875	\$25,875
Consulting	\$50,000	\$0	\$4,313	\$4,313
<i>Retail Sales Revenue</i>	<i>\$5,000,000</i>	<i>\$431,250</i>	<i>\$43,125</i>	<i>\$431,250</i>
<i>(\$500,000 in profit)</i>				
Total Sales Tax		\$431,250	\$431,250	\$485,156
Effective Sales Tax Rate		8.625%	8.625%	9.703%

Source: Tax Foundation Calculations

No state hews perfectly to the ideal of avoiding the taxation of business inputs altogether, Oklahoma certainly included. Nevertheless, Oklahoma should take care not to lean on these intermediate transactions as a source of revenue in any sales tax base-broadening efforts.

Some of the services that are currently excluded from the base could constitute either a final consumer transaction or a business input, depending on the identity of the purchaser. In such instances, the state should either define the categories in a way that excludes business inputs, or, preferably, provide a mechanism by which business purchases of such services are exempted. This could be done through sales tax exemption certificates for businesses or in a manner that is similar to how purchases of nonprofit organizations are exempted in many states.

### **Base-Broadening Options and Potential Revenue Impact**

Modernizing Oklahoma's sales tax base to include services will go a long way to ensure stability and keep sales tax revenues from eroding. Base broadening should also be considered as a way to help pay for rate reductions in either the state sales tax rate or individual income tax rates, but the state should have reasonable expectations for how much revenue such a change can produce.

If we imagine a highly implausible scenario in which Oklahoma suddenly broadened its base to the point at which it taxed all personal consumption that involves a financial transaction and is legal to tax, the state would generate an additional \$1.8 billion a year in sales tax revenue, adjusting for likely compliance.<sup>[44]</sup> It is worth noting that this extremely broad base includes things like health care, insurance, and private education, the inclusion of which is unlikely to be politically viable. Crucially, even this extremely aggressive scenario does not generate nearly enough revenue for repeal of the individual income tax.

Conversely, a responsible base-broadening plan would be able to raise \$942 million a year in additional revenue. Some items may be relatively uncontroversial, like car repairs and movie theater admission. Others, like household utilities and dental care, make good policy sense but require more political will. Because sales tax base expansion does not have to be an all-or-nothing endeavor, the following table estimates how much annual revenue each item would provide if added to the base. If every item on the list were taxed, the resulting revenue of \$942 million would represent an increase of approximately 28 percent in annual state sales tax collections. This revenue could be used to pay down individual income tax rate reductions, as discussed previously.

### **Income and Sales Tax Rate Reduction Choices**

A well-structured sales tax is more economically efficient than income taxes (as discussed elsewhere), so using revenue from sales tax base broadening to pay down income tax rather than sales tax rate reductions enhances the state's tax competitiveness.<sup>[45]</sup>



**Table 8. Base Broadening Options with Revenue Estimates**

Base Broadener	Revenue Generation	
	Cumulative	Component
Motor vehicle maintenance and repair	\$80,293,379	\$80,293,379
Motor vehicle leasing	\$97,033,823	\$16,740,444
Campgrounds and related recreational services	\$113,034,179	\$16,000,356
Movie theater admission	\$115,468,353	\$2,434,174
Live entertainment, excluding sports	\$143,420,612	\$27,952,259
Veterinary and other pet services	\$163,637,016	\$20,216,404
Package tours	\$169,601,677	\$5,964,661
Recreational vehicle and sports equipment maintenance and repair	\$171,742,836	\$2,141,159
Professional and other services (personal consumption)	\$249,020,763	\$77,277,927
Personal care and clothing services	\$298,918,808	\$49,898,045
Gambling	\$352,882,827	\$53,964,019
Audio-video and similar services	\$407,579,768	\$54,696,941
Postal and delivery services (non-USPS)	\$411,145,959	\$3,566,190
Household maintenance services	\$450,095,542	\$38,949,583
Parking fees and tolls	\$475,768,013	\$25,672,472
Club memberships and participant sports centers	\$526,692,150	\$50,924,137
Museums and libraries	\$526,703,644	\$11,494
Financial service charges, fees, and commissions	\$676,739,811	\$150,036,167
Dental services	\$743,411,306	\$66,671,495
Household utilities	\$942,246,134	\$198,834,829

Revenue in Millions of Dollars

*Source: U.S. Bureau of Economic Analysis; Oklahoma statutes; Tax Foundation calculations.*

In using base broadening to pay down income or other tax rates, policymakers should avoid the temptation to chase a specific rate and find base broadeners sufficient to pay down such a rate reduction even if that expanded base undermines the state's tax competitiveness. This is an inversion of the process, and while lawmakers should ask the hard questions and balance difficult base-broadening choices against the promise of significant rate reductions, they should not feel under pressure to tax transactions they know should not be in the sales tax base, simply because it is necessary to achieve a preset rate target. Taxes on income, for all their shortcomings, are less economically harmful than taxes that fall directly on capital investment, which is what happens when sales taxes are imposed on business inputs.

### **Sourcing Rules for Services**

Under most circumstances, state sales taxes are destination-sourced, meaning that the relevant taxing authority is the one with jurisdiction over the location at which a customer receives a product. For these purposes, receipt is typically synonymous with taking possession, so a consumer who purchases an item in a Tulsa store pays Tulsa sales tax (collected by the seller at the point of sale) even if she then takes her purchase home to Stillwater. If, however, she bought the product online and it was shipped to her Stillwater address, it is the Stillwater sales tax that applies.

For tangible property, sourcing is relatively easy. There tends to be a clearly defined physical location where a good is received. The same goes for some services, particularly those involving on-site labor. In many cases, however, services are performed in a different location than the one in which they are received. Hiring a home cleaning service poses few challenges—but how about a cloud computing service?

Sometimes the determination is complex. If a customer who lives in Edmond pays for a digital service offered by a company headquartered in San Francisco but served out of a data center in Austin, and that customer uses the service while on vacation in Honolulu, to which jurisdiction is the service sourced? Or if, for sake of argument, business-to-business services are taxed (even though they should not be), if a company based in New York City pays for a customer relations database that is used by salespeople across the country, including sales teams based in Norman and Lawton, is any portion of that transaction taxable in Oklahoma?

Within corporate taxation, some states have adopted a “look-through” approach for corporate apportionment, based on the location of the customer’s own customers. Under this approach, if a service contracted in Utah was ultimately consumed (either by the company or its customer) in another state, Utah would not tax it, but if the customer’s customer was in [Utah](#), that transaction would be sourced—or partly sourced—to the state. This approach has relatively little appeal in sales taxation, because it is complex and requires an assessment of a service’s use over time, information that may not be available when the sale is transacted.

Therefore, Oklahoma would do well to avoid look-through and source services consistent with its current sales tax code, with receipt of a service sourced to wherever first use is made of the service, or for digitally transferred services, taking possession or making first use.<sup>[46]</sup> This approach cuts down substantially on complexity for taxpayers and tax collectors alike, and requires no change to the state’s existing sourcing rules.

Sourcing, moreover, is chiefly relevant for business and professional services, and is most complex for those purchased by businesses. Exempting business inputs, consistent with good tax policy, clears most of the complexity of sourcing. While it would remain a relevant issue for professional services consumed by individuals, the determination is rarely complex. An Oklahoma resident individual using a service would pay the sales tax on their fees; an Oklahoma company providing a service to an Arkansas customer would not collect sales tax on Oklahoma’s behalf.

### **Adjusting Local Option Sales Taxes**

Oklahoma’s high-rate local option sales taxes pose a challenge for reformers, both because they limit the capacity for state sales tax rate increases and because broadening the sales tax base would increase local tax collections in the absence of commensurate rate reductions, yielding a sizable tax increase. The high rates are largely a consequence of Oklahoma’s low property (ad valorem) taxes, which reflects policy choices at both the local and state levels. In particular, Oklahoma restricts city governments from imposing property taxes, pushing them toward heavier reliance on

sales taxes.

Reducing local sales tax reliance would require tackling ad valorem taxation, discussed elsewhere. Even if sales taxes continue to raise the same amount of revenue for local governments, however, the rates themselves can and should come down if the sales tax base is meaningfully broadened. At the state level, this additional revenue could be used to pay down income tax rate reductions, making taxpayers whole. At the local level, however, base broadening could be a net positive to localities—and an extra tax burden for residents—unless adjustments are made.

Conceptually, the ideal policy would be rate reductions commensurate with base broadening. If, for instance, the base was broadened by 20 percent, the rate should be reduced by 17 percent, yielding the same amount of revenue. Because local governments possess rate-setting authority, however, pushing a uniform rate-trimming across all jurisdictions is likely to be prohibitively difficult. An aggressive solution would be to impose a levy limit on local sales taxes, requiring rates to be rolled back to keep collections constant (plus inflation and any allowable growth factor). Alternatively, the state could cap local sales taxes at a rate calculated to limit local jurisdictions' ability to increase revenue under a sales tax base-broadening plan.

Failing that, policymakers could consider another approach, leaving local sales tax rates alone, but reducing state aid to localities by formula to account for additional local sales tax revenue. If desired, the state could even give local governments a choice by tying the state aid formula to the growth in local sales tax collections. Localities could maintain current state funding levels by lowering their sales taxes to offset the broader sales tax base or could accept reduced funding while keeping rates higher. Either way, the goal would be to avoid an overall tax increase due to sales tax modernization.

### **Sales Tax Reform in Other States**

Several states, including Hawaii, New Mexico, North Dakota, and [South Dakota](#), already have fairly broad sales tax bases, though often with an overreliance on business inputs. Recent efforts to adopt significant base broadening have fallen short in several states, including in Illinois, [Maine](#), [South Carolina](#), and Utah, where proposed by Republican governors, and [Connecticut](#) and Pennsylvania under proposals by Democratic governors. In at least some of these states, however, reform remains on the table.

Other parts of the country, moreover, have succeeded in adopting base broadening on a moderate scale in recent years. Examples include Iowa, [Kentucky](#), North Carolina, and the District of Columbia.

In Kentucky, as part of a broader tax reform package, lawmakers expanded the sales tax base to include many (primarily) personal services, including:

- landscaping;
- janitorial services;
- pet care and grooming;

- small animal veterinary services;
- fitness and recreational sports;
- laundry, dry cleaning, and linen supply;
- nonmedical diet and weight loss centers;
- limousine services;
- bowling;
- overnight trailer campgrounds;
- extended warranties; and
- select other personal services.[\[47\]](#)

In North Carolina, an emphasis was placed on taxing services delivered by providers with an existing sales tax collections obligation. Beginning in 2017, a range of installation, repair, maintenance, and service charges were added to the sales tax base. The rationale for inclusion of these services, in particular, was that the service providers were already sales tax collectors in some aspects of their business, charging tax, for instance, on the tangible property being installed, or on parts used for maintenance and repair. Accordingly, broadening the sales tax base to cover other transactions in their purview did not require new sellers to register and begin collections for the first time. It should be noted, though, that within the existing base—whether in North Carolina, Oklahoma, or anywhere else—many very small sellers succeed in complying with the sales tax, and there is little reason to believe that new services providers could not as well.

Iowa is typical of the states that have broadened their sales tax bases specifically to digital goods, like e-books, movie and music downloads, file storage, and software as a service (cloud-based software). Ride-sharing services are also included in the base broadening.[\[48\]](#) Criterion cited by a tax commission in the District of Columbia in advance of the adoption of its tax reform package included (1) purchase by final consumers and (2) services linked to tangible goods or real property situated in the District, making them difficult to purchase online or in another state.[\[49\]](#)

Newfound authority to tax remote sales,[\[50\]](#) along with Oklahoma's size and geography compared to the District of Columbia, may suggest greater possibilities in the Sooner State. Moreover, one might expect that, while [Washington, D.C.](#) hosts the offices of many professional service providers, the personal consumption of those services is more likely to take place in neighboring jurisdictions, limiting the appeal of such base broadening in a way that is less relevant to Oklahoma.

Ideally, Oklahoma would exceed the base broadening implemented by Kentucky, North Carolina, Iowa, and the District of Columbia, among others, though successes here provide encouragement as to the possibilities. Base broadening worked for these places. Oklahoma has the opportunity to go bolder—and to use the revenue to make its income tax more competitive.

## Property Taxes

The *ad valorem* tax, Oklahoma's unusual nomenclature for its property tax, takes a backseat in local government finance compared to the role that property taxes play in other states. Property taxes are often thought of as a tax on land and structures (what is termed "real property"), which is true, but they are also imposed on tangible personal property, which is property that can be touched or moved. Despite the "personal" part of the name, almost all such property subject to taxation in Oklahoma is business property: machinery, equipment, and inventory.

In fact, 49 percent of all *ad valorem* taxes in Oklahoma are paid by commercial entities, almost evenly split between taxes on their real and personal property. Businesses pay property taxes on everything from their land and buildings (as one would expect) to their machinery and equipment, their furnishings and fixtures, and even the inventory they hold to sell to customers. When imposed on land and structures, the property tax can be quite economically efficient, but when it falls on capital investment, or on products being held for sale, it can distort decision-making and undermine the state's tax competitiveness. Oklahoma generally has low property taxes on homeowners, but treats commercial enterprises unfavorably compared to many of its peers.

### Oklahoma's Limited Reliance on Property Taxes

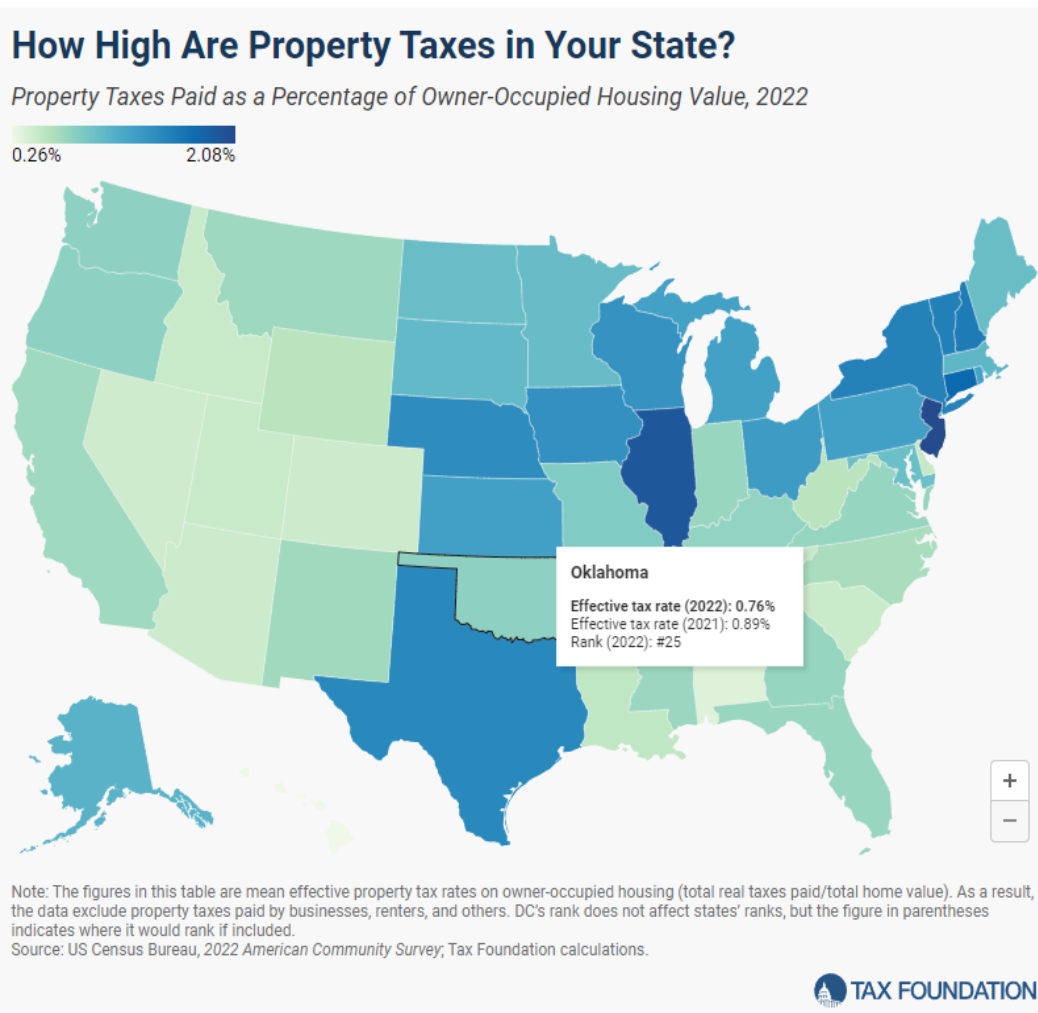
Oklahoma relies on property taxes less than many other states. As a result, Oklahoma residents experience property tax burdens well below the national average. These effective rates are especially competitive compared to neighboring Texas and [Kansas](#). Oklahoma homeowners face effective property taxes of 0.76 percent of the fair market value of owner-occupied housing.<sup>[51]</sup> Residents of Texas and Kansas, on the other hand, face effective rates of 1.47 percent (seventh highest) and 1.26 percent (13th highest) respectively.

The state's low *ad valorem* taxes are largely explained by the fact that not all localities have the authority to levy these taxes, and that they are primarily used for school finance, whereas in much of the country, property taxes fund schools as well as local government operations. Counties, school districts, and assorted local health or emergency services may levy *ad valorem* taxes in Oklahoma, but cities may not, and local government operations are largely funded from local option sales taxes.<sup>[52]</sup>

This is atypical among states. Ordinarily, the property tax is the main source of local revenue, accounting for 72.0 percent of local tax collections nationwide in Fiscal Year 2022.<sup>[53]</sup> In Oklahoma, on the other hand, property taxes only provided 53.5 percent of local tax collections the same year. Most of the remaining revenue came from sales taxes, which accounted for 40.1 percent of local collections.

There are good reasons that property taxes are typically an important local funding source. Property taxes are more transparent than most other tax types: people often have a greater sense of what they pay in property taxes each year than they do for income taxes (much of which are typically withheld), let alone for sales taxes, which are





paid in bits and pieces over the year. This transparency is good, but also makes the burden compare unfavorably to the burdens of other, less transparent, taxes in the minds of many taxpayers.

Property taxes are also imposed on the value of owned property, which strikes some as unfair (paying taxes on something they already own), but which helps taxes on real property accord reasonably well with what is known as the benefit principle, where taxes are imposed in proportion to the benefit the taxpayer receives. The value of one's property corresponds, if imperfectly, with the market value of the benefits governments provide, like roads, police and fire protection, and schools. In fact, some of these expenditures are self-reinforcing: a better school district can improve the value of a property.

### **Local *Ad Valorem* Tax Authority**

While it should not be considered a tax reform goal in and of itself, a gradual shifting of local reliance away from sales taxes and onto the property tax would allow the state more freedom in raising sales taxes to pay for other tax reform options in the future. Modestly higher rates on the sort of property that is appropriate to tax could also help reduce or eliminate reliance on classes of property that are rightly exempted in many

states. As with any tax policy change, however, this shift would not be without trade-offs or difficulties.

Counties and school districts already have property tax authority, whereas ad valorem authority in cities is quite limited, consistent with its primary role of funding education to the exclusion of other local government services. Consequently, Oklahoma also relies more on state transfers to fund local government than many of its peers do. Ultimately, while it is a difficult undertaking, policymakers may wish to consider expanding property tax authority for both cities and counties to allow the tax to be used to fund more general government operations.

The issue of local property tax reliance is not one that can or should be solved overnight. However, it is necessary to be aware of the structuring of Oklahoma's property tax authority in order to understand how the state's local funding reliance can act as a restraint on state-level policy changes.

### **Tangible Personal Property Taxes**

Oklahoma's property tax rates may be low, but there is more to a tax burden than rates alone. Tax structure can make a large difference in who bears the brunt of taxes and what their burdens look like. In Oklahoma's case, overall low rates help mitigate the damage from several uncompetitive structural elements.

As discussed earlier, taxes levied on real property generally align with the "benefit principle" of taxation: the beneficiaries of services are the ones funding those same services. The taxes are ideally levied on real property, and the property owners that pay taxes benefit from local services like schools and fire departments. Additionally, landowners cannot move their land in order to avoid tax liability—it is an immobile asset.

However, property taxes start to diverge from the benefit principle and cause economic distortion when they are levied on more than just real property. This is the case in Oklahoma and many other states which include tangible personal property (TPP) in their tax bases. The Sooner State relied on TPP for 22.74 percent of its property tax revenue in 2017, which is anomalously high.<sup>[54]</sup> In fact, while other states are showing a decreasing reliance on TPP, Oklahoma's reliance on TPP has increased in recent years.<sup>[55]</sup>

In contrast to real estate, TPP includes anything that can be touched or moved. Taxes targeted at TPP often fall on business inputs, as property such as machinery, equipment, and fixtures are part of a firm's production process, and their inventory—either of their own manufactured goods or those obtained at wholesale for sale to consumers—is part of their core business activity. Firms may pass along the tax in the form of higher prices when goods or services are sold in the production process, to the extent that their competitors are similarly disadvantaged. This may conceal the impact of the tax on consumers, as consumers may pay higher prices as a result of a tax on TPP. Companies competing in a multistate market against competitors not subject to such taxes are placed at a competitive disadvantage, as their peers elsewhere face lower tax costs on production.

As with a typical property tax, TPP liability is calculated by first determining the assessed value of the property and multiplying it by the assessment ratio for that class of property and finally by the millage (rate). However, determining the assessed value of TPP is much more involved than assessments on housing or real estate. These taxes are “taxpayer active”—the person paying the tax is responsible for keeping careful records of their possessions and how much they owe to the state. They must know the initial acquisition price of an asset and when it was placed into service, and they must depreciate it according to published schedules for each asset type. This creates significant compliance burdens for taxpayers in addition to the actual cost of the tax.

Assessment ratios may also be higher for TPP than for real residential property. Oklahoma is one of 15 states that allows localities to apply different assessment ratios for TPP than for other classes of property. Many localities take advantage of this freedom. In Oklahoma City, for example, real property sees an assessment ratio of 11 percent, while tangible personal property has a ratio of 13.75 percent.<sup>[56]</sup> According to statute, all types of TPP—whether inventory, machinery and equipment, or business furniture—are included under the classification of personal property.<sup>[57]</sup>

Taxes on TPP are a source of tax complexity and non-neutrality, incentivizing firms to change their investment decisions or relocate to avoid the tax. Because they are levied on the value of a business’s tangible assets, TPP taxes reduce the return that can be generated by those assets. This can dissuade firms from making marginal investments in their enterprises.

Imagine, for example, a manufacturing firm considering a new investment in machinery that faces a 1.2 percent effective TPP tax rate annually (the average effective rate on inventory in Oklahoma). If the machinery can be fully expensed and depreciates at 5 percent per year, the effective tax rate on the marginal investment in machinery is 15 percent due to the TPP tax.<sup>[58]</sup> This means that at the break-even point, where an investment just covers costs in present value, marginal investment faces a 15 percent tax rate. This means that an investment that breaks even—earning a zero percent net return and covering costs in present value—faces a 15 percent tax rate. In other words, 15 percent of the gross return from the marginal investment covers the TPP tax. A TPP tax dissuades firms from making new investments.<sup>[59]</sup>

Seven states ([Delaware](#), Hawaii, Illinois, Iowa, New York, Ohio, and Pennsylvania) exempt all tangible personal property from taxation, while another five states (Minnesota, [New Hampshire](#), New Jersey, North Dakota, and South Dakota) exempt most such property from taxation except for select industries that are centrally assessed

## The Inventory Tax

While most states tax tangible personal property in some way, Oklahoma is one of 12 states—along with [Alaska](#), Arkansas, Georgia, Kentucky, Louisiana, [Maryland](#), [Massachusetts](#), [Michigan](#), Mississippi, Texas, and [Vermont](#)—that tax some or all inventory. Taxes on inventory are non-neutral, as businesses with larger quantities of inventory, like manufacturers and retailers, are disproportionately burdened by such

taxes. Businesses with little to no inventory escape this form of property taxation, despite using local and state government services like firms with larger amounts of inventory.

Because it is levied on the value of a company's inventory, this base decision is especially harmful to large retail stores and other businesses that store large amounts of merchandise. Inventory taxes are highly distortionary, because they force companies to make decisions about production or stocking that are not entirely based on economic principles but rather on how to pay the least amount of tax on goods produced or held for sale. Inventory taxes also create strong incentives for companies to locate inventory in states where they can avoid these harmful taxes. Oklahoma's freeport exemption provides for inventory held temporarily in state for sale elsewhere,<sup>[60]</sup> but taxes inventory held in-state for ultimate in-state sale, creating an incentive to hold such inventory out-of-state where possible.

### **Economic Implications of TPP Taxation**

The Tax Foundation's Location Matters study helps illustrate the extent to which tax structure can interact with tax rates to drive corporations' overall state and local tax burdens.<sup>[61]</sup> In this study, we design eight model firms and place them in each state (as both a new and a mature firm, since new firms are eligible for many incentives denied to long-established firms), calculating their tax liability.

The model distribution center illustrates the benefit of the freeport exemption. In its absence, one would expect a particularly high tax on this type of business in a state with inventory taxation, but in fact, their tax burdens on such firms are 14th and ninth best nationwide. The benefit this model firm receives, however, is not available to companies selling to Oklahomans. Companies which sell to Oklahomans must pay taxes on their inventory regardless of how long they hold onto it.<sup>[62]</sup> The model distribution center in Location Matters is able to take advantage of the freeport exemption because it makes only out-of-state sales, while many actual distribution centers in Oklahoma may not be as fortunate.

Even for companies that mainly sell out-of-state, a nine-month limit built into the freeport exemption penalizes businesses that sell products with longer shelf lives. Additionally, businesses must apply for this exemption every year and be approved in order to avoid the tax.

Oklahoma also provides an ad valorem exemption for new and expanded manufacturers, data centers, and research and development companies.<sup>[63]</sup> While presumably intended to shield manufacturers from the tax on machinery and equipment, this exemption favors new businesses and includes a number of employment, wage, and construction requirements that further limit which companies can benefit. The inventory tax is also an impediment to businesses due to the high compliance costs associated with it.

## Reform Options

Oklahoma has already agreed to exempt short-term inventory and machinery for new manufacturers to encourage investment in the state. This concern for economic consequences is warranted, and the state should build on this strategy by working to reform its treatment of TPP (and particularly inventory) more broadly, rather than for targeted businesses.

Oklahoma's heavy reliance on tangible personal property may rule out a full repeal of TPP taxes, but there are several steps the state could take to make incremental improvements in its system.

First, the state should consider a full repeal of its inventory tax. This would undo some non-neutral tax treatment and make the state more attractive to retailers, distribution centers, and any other inventory-heavy businesses. This change would require a constitutional amendment, as the authority to tax personal property is given in the state constitution<sup>[64]</sup> and inventory is mentioned as a subset of personal property,<sup>[65]</sup> even if eligible personal property is defined more fully in statute.<sup>[66]</sup>

Because of the nature of property taxes, a state-level exclusion of inventory would have ramifications for local government revenue. Adjusting for the freeport exemption, the inventory tax brought in approximately \$148 million for Oklahoma localities in 2020. If localities were authorized or required to exclude inventory from taxation, a 3 percent increase in collections on other property would offset the lost revenue. Particularly with property tax revenues rising in Oklahoma and across the country, it may be possible for local governments to absorb this transition if phased in over a number of years, even in the absence of millage increases.

The state currently places a rate limit on school districts.<sup>[67]</sup> A constitutional amendment eliminating the inventory tax might also adjust this limit to ensure school districts can retain their current funding levels. Oklahoma allows localities to set their own assessment rates for different classes of property, as long as they remain between 10 and 15 percent for personal property and between 11 and 13.5 percent for real property.<sup>[68]</sup> As such, different localities would likely rely on different combinations of millage increases and assessment rate increases in order to keep revenue stable.

Alternatively, the state could provide aid intended to offset the elimination of the inventory tax. Some states have experimented with tax credits to businesses to defray their liability, but this approach should be avoided, as it has several shortcomings. It continues to require businesses to comply with the tax, avoiding full savings on compliance costs. It has timing effects where businesses pay the tax before being made whole with the credit. And for many businesses, the credit may be unavailable, since they may not earn a profit in a given year and have no tax liability to offset.

If the state wishes to cover the \$148 million necessary to repeal local inventory taxes, it would be far better to do so by formula-driven aid to localities. Inventory accounts for about 16.7 percent of tangible personal property tax collections, so states could



make localities whole in a largely representative manner by modifying existing local aid formulas to augment each local government’s remaining tangible personal property tax collections by about 20 percent. As the state’s economy grows, the state may be able to absorb this cost out of growth and could even build a phasedown into a broader set of tax triggers.

Oklahoma lawmakers should also consider setting a *de minimis* threshold for tangible personal property taxes more broadly. This exempts a certain amount of TPP from taxation, giving relief to businesses which would not have provided much revenue for the state—and, in some cases, may have seen compliance costs higher than their tax payments. This will take many small businesses off the rolls at minimum revenue loss. Many small businesses face negligible liability but are still forced to go through a tedious compliance process.

Any exemption threshold should also be a filing threshold. This reduces compliance costs for firms, as firms under the threshold may have to file in many localities if filing requirements remain in place even when companies’ taxable property is under the *de minimis* threshold. Indiana, for example, previously required taxpayers to file a TPP tax return and pay filing fees even if they qualified for exemption. In April 2019, the state prohibited counties from collecting TPP tax filing fees but kept the filing requirement for exempt taxpayers.<sup>[69]</sup>

Revenue impacts from a *de minimis* threshold would likely be minimal. A 2015 study on the state of Connecticut examined the possible effects of various personal property tax thresholds. The study estimated that a \$5,000 *de minimis* would decrease revenues by 0.006 percent; a \$7,500 threshold by 0.010 percent; and a \$10,000 threshold by 0.014 percent.<sup>[70]</sup> Assuming these same percentages of impact on business TPP collections in Oklahoma, potential revenue changes would be as follows—statewide:

**Table 9. Potential Revenue Impacts of *De Minimis* Thresholds**

Threshold Amount	Revenue Decrease
\$5,000	\$55,805
\$7,500	\$93,008
\$10,000	\$130,212

Source: Lawrence C. Walters; Tax Foundation calculations.

The state has many examples to follow if it pursues this route. Indiana recently raised its *de minimis* exemption from \$20,000 to \$40,000 in business personal property per county and prohibited counties from collecting TPP tax filing fees from businesses that file but do not have a tax liability.<sup>[71]</sup> Indiana originally implemented its \$20,000 *de minimis* exemption in 2015, and 89,749 taxpayers took advantage of the exemption.<sup>[72]</sup> An additional 28,300 exemptions were projected by the Indiana Legislative Services Agency as a result of the increase in the exemption threshold.

Fourteen states broadly exempt tangible personal property from taxation, and 10 others offer *de minimis* exemptions despite imposing taxes on TPP.<sup>[73]</sup> These exemptions

avoid unduly burdening businesses with only a small amount of potentially taxable property. Several states have adopted or expanded *de minimis* exemptions in recent years, including [Colorado](#) (to \$50,000), [Idaho](#) (to \$250,000), Indiana (to \$80,000), [Rhode Island](#) (new, at \$50,000), and Utah (to \$25,000).<sup>[74]</sup>

If Oklahoma decides to implement a *de minimis* exemption, it should index this exemption for inflation. Otherwise, while the nominal value of the exemption will stay the same, the real value will decrease, exposing progressively smaller companies to tangible personal property taxes.

If Oklahoma decides to implement a *de minimis* exemption, it should index this exemption for inflation. Otherwise, while the nominal value of the exemption will stay the same, the real value will decrease, exposing progressively smaller companies to tangible personal property taxes.

Making changes to the property tax base may be more complex than making tax changes on the state level. However, removing inventory from the tax base and creating an exemption for businesses under a certain level of personal property would go a long way to simplify the state's property tax system. A property tax that does not unfairly penalize certain businesses over others will create an environment that is more welcoming to businesses both new and old.

## Conclusion

Oklahoma policymakers have a range of options to make their tax code more attractive to individuals and businesses alike. Some are big actions, like dramatically reducing reliance on, or even eliminating, the individual income tax, which will require thoughtful consideration and long-term fiscal planning. Others may be much less well-known, like repealing the throwback rule or phasing out the taxation of inventory, but could still have a profound impact on Oklahoma's competitive standing.

Several of the proposals in this publication could be adopted on a standalone basis, because they would have a negligible revenue impact or because they could be reasonably paid for out of anticipated revenue growth. Others are best accomplished with tax swaps, pairing additional revenues generated from more economically efficient taxes with reduced reliance on more distortive modes of taxation. Revenue triggers, better designed than the ones Oklahoma tried previously, can also help ensure that a portion of future revenue growth is dedicated to enhancing Oklahoma's tax climate.

The state's options include:

### Individual Income Tax Reforms

- 3 percent top marginal income tax rate, in an across-the-board cut, paid for with moderate sales tax base broadening
- 2 percent or lower top marginal income tax rate due to sales tax base broadening and higher sales tax rates

- Single-rate income tax with a \$10,350 standard deduction
- Consumed income tax with a higher rate but the elimination of the tax's current penalty on saving and investment
- Income tax rate reductions phased in over time using revenue triggers
- Adopt 30-day filing threshold for nonresidents

### **Corporate Income Tax Reforms**

- Repeal of the throwback rule to eliminate the corporate tax's penalty on in-state sellers
- Single sales factor apportionment to eliminate the current heavier taxation of in-state investment

### **Sales Tax Reforms**

- Moderate base broadening (about \$942 million at current rates) to modernize and stabilize the tax base while facilitating income tax rate relief
- Sourcing of the sale of services to the market, and not where the service is performed
- Adjusting local option sales taxes to maintain revenue neutrality at the local level if sales tax bases are broadened

### **Property Tax Reforms**

- Adopting a de minimis exemption for tangible personal property to take the smallest businesses entirely off the tax rolls
- Repeal of the inventory tax, either with a local phaseout or state transfers

The Tax Foundation's 2025 *State Tax Competitiveness Index*, which measures tax structure, can help illustrate how some of these reforms would enhance Oklahoma's competitive standing. The Index scores states across five broad tax categories (corporate, individual, sales and excise, property and wealth, and unemployment insurance taxes), with rankings within each category and overall. While not every reform proposed in this publication would affect Oklahoma's performance on the *Index*, many of the major reforms would yield significant improvements from the state's current 21st place ranking.

Several possible reforms are ranked separately here, then scored again as comprehensive reform packages. Within the comprehensive reform package, converting the individual income tax to a single-rate tax is also contemplated. Of course, many variations of these plans are possible, and several additional valuable reforms would not be reflected on the *Index*.

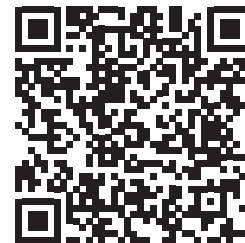
**Table 10. Sample Tax Reform Options with Projected State Tax Competitiveness Index Rankings**

	Overall	Corporate	Individual	Sales	UIT	Property
Current Ranking	21	5	28	32	6	15
3% Top PIT with Sales Tax Broadening	17	5	18	31	15	6
Inventory Tax Repeal	20	5	28	32	14	6
Throwback Rule	21	5	28	32	15	6
30-day filing & withholding threshold	20	5	24	32	15	6
All Reforms Listed Above	17	5	24	31	14	6
All Reforms with 3% Flat Tax	14	5	14	31	14	6

*Source: 2025 State Tax Competitiveness Index; Tax Foundation calculations.*

There is clear appetite for tax reform in Oklahoma—serious, meaningful reform that not only reduces rates but positions the state for long-term success. Oklahoma’s competitors are not resting on their laurels, and Oklahoma faces an urgent need to further diversify its economy and compete with regional and national rivals. Tax reform is not the only thing that matters in attracting people and jobs to the Sooner State, but it is a valuable tool in the legislature’s toolkit. Lawmakers should finish the work they have begun over the past few decades, tackling tax rates *and* structures to give the state a leg up in an era of enhanced competition.

**Scan the QR code to view the report online and access interactive features**



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Oklahoma policymakers have been grappling with tax reform for decades, spurred by a desire to enhance the state's competitiveness, and particularly to better compete with regional peers. While reforms have yielded meaningful reductions in both individual and corporate income tax rates, many elements of Oklahoma's tax code remain an impediment to its competitive standing.

Fortunately, Oklahoma finds itself in a good position: the state is in need of pro-growth tax reform at the very same time that it has a revenue buffer to help absorb transition costs from tax policy changes.

This publication is designed to provide policymakers with a menu of options: some of them bold, comprehensive approaches and others small stand-alone policy tweaks, but all designed to make Oklahoma a more attractive place to live and work. The state needs a growth agenda, and it cannot come too soon.



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