BILL # SB 1335 **TITLE:** standard income tax deductions; amounts

SPONSOR: Garcia **STATUS:** As Introduced

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FISCAL ANALYSIS

Description

Under current law, a taxpayer may elect to claim either a standard or itemized deduction for Arizona individual income tax purposes. Starting in tax year 2007, SB 1335 would increase the standard deduction amounts from $4,247 to $5,445 for singles and married couples filing separate returns and from $8,494 to $10,890 for head of households and married couples filing joint returns. The new statutory deduction amounts would continue to be adjusted for inflation each year. According to the Department of Revenue (DOR), the tax year 2007 deductions amounts will not be determined until July 2007. The current standard deduction amounts are for tax year 2006.

Estimated Impact

Beginning in FY 2008, the bill is estimated to reduce individual income tax collections by $(43.4) million.

Note that the estimate above is based on a static model and does not incorporate a "dynamic" estimate. Dynamic forecasting goes beyond the static approach and attempts to predict changes in the economy brought about by changes in tax policy. The income tax reduction under SB 1335 would lead directly to increases in households' disposable income. As a result, the bill would generate additional consumer spending and hence economic activity that would lead to an offsetting increase in tax collections. However, this type of secondary, or dynamic impact, is difficult to estimate.

Dynamic estimates are based on complex econometric models. Based on national research, these models typically generate dynamic revenue feedbacks ranging from 2% to 20% of the static revenue impact within 5 years. In other words, up to 20% of the static revenue loss would be offset by revenues generated by greater economic activity. The specific feedback will depend on the type and magnitude of the tax reduction. Due to time constraints, this analysis does not include a dynamic forecast for SB 1335. The impact, however, can be expected to fall within the typical dynamic feedback range.

Analysis

According to DOR, this bill would reduced individual income tax collections by $(43.4) million beginning in FY 2008. This estimate, which is derived from the department's individual income tax micro-simulation model, assumes that the new amounts prescribed under the bill will not be adjusted for inflation until tax year 2008.

Local Government Impact

Each year, incorporated cities and towns receive 15% of income tax collections from 2 years prior. This bill would reduce local government distributions by $(6.5) million beginning in FY 2010.

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