Fiscal Note

BILL # HB 2001 (2nd Special Session)

TITLE: Arizona commerce authority; business incentives

SPONSOR: Adams

STATUS: As Introduced

PREPARED BY: Hans Olofsson/Ted Nelson

Description

This bill makes several changes to Individual and Corporate Income Taxes and Property Taxes and creates the Arizona Commerce Authority. Please see the attached detail for more information.

Estimated Impact

This bill is estimated to cost $38.2 million in FY 2012, growing to $538.0 million in FY 2018, when all the provisions are fully implemented.

The analysis does not reflect the behavioral responses of corporations and individuals to a decrease in tax liabilities. Decreasing liabilities can serve as an incentive for businesses to employ more capital and labor, and individuals to spend and invest more than they otherwise would. These "dynamic" effects may result in an increase in economic output, which in turn may generate more tax revenue dollars for the state General Fund than what a "static" analysis assumes.

2/15/11

General Fund Impact of Tax Provisions in ACA Bill – HB 2001/SB 1001, 2nd Special Session ($ Millions) 1/2/

Description of Provision	Tax	FY 12	FY 13	FY 14	FY 15	FY 16	FY 17	FY 18
Phases down Class 1 (commercial) property assessment ratio from 20% to 18% over 4 years, beginning in TY 2013	Property			(3.4)	(7.2)	(11.6)	(16.5)	(17.4)
Reduces Class 2 (agricultural) property assessment ratio from 16% to 15% in TY 2016	Property						(2.4)	(2.7)
Reduce Homeowner Rebate costs by limiting to primary residence & requiring affidavits	Property		39.0	39.0	39.0	39.0	39.0	39.0
Increases Homeowner Rebate % to offset Class 3 tax shift due to Class 1 & 2 assessment ratio reductions, beginning in FY 2014	Property			(15.6)	(34.1)	(55.7)	(93.0)	(100.5)
Reimburses County Assessor' Costs for Implementation of Homeowner Rebate changes, beginning in FY 2013	Property		(2.0)	(2.0)	(2.0)	(2.0)	(2.0)	(2.0)
Changes personal property exemption inflation factor to cost employment index	Property			-	-	-	-	-
Increases depreciation of business personal property, beginning in TY 2012	Property	-	(4.8)	(4.8)	(4.8)	(4.8)	(4.8)	(4.8)
Increases small businesses eligibility for 30% "Angel" investment credit from $2m to $10m in assets	Individual Income	(4.0)	(4.0)	(4.0)	(4.5)	-	-	-
Eliminates capital gains on income derived from small businesses, beginning in TY 2014	Individual Income	-	-	-	(11.6)	(12.3)	(12.9)	(13.6)
Phases down corporate tax rate from 6.968% to 4.9% over 4 years, beginning in TY 2014	Corporate Income	-	-	-	(53.8)	(116.0)	(183.5)	(269.6)
Phases in corporate sales factor from 80% to 100% over 4 years, beginning in TY 2014	Corporate Income	-	-	-	(24.6)	(47.3)	(67.8)	(84.0)
Increases university-related R&D credit by 10%, beginning in TY 2012	Corporate & Individual Income	-	(4.0)	(4.0)	(4.0)	(4.0)	(4.0)	(4.0)
Creates annual $3,000 3-year new job credit with conditions	Corporate / Individual Income & Insurance Premium	(6.7)	(13.4)	(29.8)	(47.7)	(52.7)	(53.7)	(50.9)
Eliminates Enterprise Zone Program	Corporate / Individual Income & Property	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Diverts withholding tax to Arizona Commerce Authority, beginning in FY 2012	Individual Income 3/	(31.5)	(31.5)	(31.5)	(31.5)	(31.5)	(31.5)	(31.5)
Total General Fund Impact		**($38.2)**	**($16.7)**	**($52.1)**	**($182.8)**	**($294.9)**	**($429.1)**	**($538.0)**

Notes:
1/ Cost to General Fund appears as a negative and savings appears as a positive.
2/ Property tax changes are estimated after truth-in-taxation adjustments.
3/ Plus $3.5 million of lottery proceeds previously designated for Department of Commerce.

Description of Fiscal Impact Provisions in the Arizona Commerce Authority (ACA) Bill

Phase-Down of Class 1 (Commercial/Industrial) Property Assessment Ratio
The provision phases down the assessment ratio for Class 1 (commercial and industrial) property from 20% to 18% over 4 years, beginning in Tax Year (TY) 2013. Based on projected growth in net assessed valuation (NAV), it is estimated that this provision will reduce statewide NAV by $(600) million, beginning in FY 2014. Under the state's K-12 funding formula, such a NAV loss is expected to increase General Fund formula costs for schools by $22.1 million, beginning in FY 2014. If the school tax rate adjustments under the state's truth-in-taxation (TNT) provisions are allowed to take place, however, the cost would be reduced to $3.4 million. When fully implemented in FY 2017, the corresponding cost would be $16.5 million.

Decrease of Class 2 (Agricultural) Property Assessment Ratio
The provision reduces the assessment ratio for Class 2 (agricultural) property from 16% to 15% in TY 2016. Based on projected growth in NAV, it is estimated that this provision will reduce statewide NAV by $(420) million, beginning in FY 2017. Under the state's K-12 funding formula, such a NAV loss is expected to increase General Fund formula costs for schools by $15.4 million, beginning in FY 2017. If the school tax rate adjustments under the state's truth-in-taxation (TNT) provisions are allowed to take place, however, the cost would be reduced to $2.4 million.

Reduce Homeowner’s Rebate Eligibility
The state subsidizes 40% of the cost of a homeowner’s school property taxes. This provision would reduce Homeowner’s Rebate costs by 1) limiting the program to in-state residents only and 2) requiring homeowners’ to submit an affidavit that the home represents their primary residence. The provision is expected to save $39.0 million starting in FY 2013. This estimate assumes that approximately 25% of rental homes in the state are currently misclassified and that 6.5% of homes in Arizona are “second” homes based on U.S. Census data.

Increase Homeowner’s Rebate Percentage
This provision would increase the Homeowner’s Rebate percentage for FY 2014 through FY 2018 by an amount to be determined by DOR that would offset for homeowners the tax shift that otherwise would occur under the bill due to assessment ratio changes for Class 1 and Class 2 properties. This is estimated to increase state costs for the Homeowner’s Rebate by $15.6 million in FY 2014, and grow to $93.0 million in FY 2017 when fully implemented.

Reimburse County Costs
This provision would require the Legislature to reimburse counties in FY 2013 for costs of administering the new Homeowner’s Rebate affidavit process in calendar year 2012. Based on initial input from Maricopa County, this cost is estimated at $2 million statewide per year starting in FY 2013.

Change of Business Personal Property Exemption Inflation Factor
Under current law, personal property that is used for agricultural purposes or in a trade or business is exempt from taxation up to a maximum amount of $50,000 in full cash value per taxpayer. This amount is automatically adjusted for inflation each year, as measured by the GDP Price Deflator, and is currently $67,268. Beginning in TY 2012, this provision would replace the GDP Price Deflator with the Employment Cost Index for purposes of calculating the inflation-adjusted exemption amount each year. Based on a recent forecast provided by Global Insight, the use of the new inflation factor would increase the personal property exemption amount for FY 2013 by about $600. Such a small increase is expected to have a negligible impact on statewide NAV and hence the General Fund.

Increase of Business Personal Property Depreciation
Current law provides that business and agricultural personal property receive an additional depreciation over and above the regular depreciation allowance. This provision would increase the amount of additional depreciation relative to what is currently allowed. Based on an analysis provided by the Maricopa County

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Assessor's Office for a comparable measure (HB 2363) in the 2007 legislative session, it was estimated at that time that increased property depreciation would reduce statewide NAV by $(118) million in the bill's first year of implementation. Based on property growth since 2007, it is estimated that the corresponding NAV loss in TY 2012 would be approximately $(130) million. Under the state's K-12 funding formula, a NAV loss of such magnitude is expected to increase General Fund formula costs for schools by $4.8 million, beginning in FY 2013. Since the provision would only apply to personal property initially acquired during or after TY 2012, there would be no offsetting first-year TNT savings.

Expansion of Small Business Eligibility for "Angel" Investment Credit

The provision would increase eligibility for tax credits available to "angel" investors in certain small businesses. The current credit allows qualified investors to receive a 30% credit over 3 years on investment in qualified businesses (35% if business is located in a rural area or is a bioscience enterprise). The credit has a $20 million cap, of which $3.5 million is projected to be used under current law. While the credit authorization is set to expire at the end of FY 2011, this provision would extend such authorization by 4 years, through the end of FY 2016. Additionally, the provision would also expand eligible small businesses to include companies with assets up to $10 million, as opposed to the current asset cap of $2 million, and allows ACA to determine eligible sectors. The provision is estimated to exhaust the remaining $16.5 million in credits at a cost of $(4.0) per year from FY 2012 – FY 2014, and $(4.5) million in FY 2015.

Elimination of Capital Gains on Income Derived from Small Business

This provision eliminates capital gains on income derived from investments in small businesses with assets up to $10 million, beginning in TY 2014. The cost of this provision is estimated to be $(11.6) million in FY 2015. The cost estimates are based on TY 2008 Arizona capital gains data provided by the Internal Revenue Service (IRS), further adjusted for the Congressional Budget Office's (CBO) January 2011 capital gains forecast. Under this forecast, it is estimated that Arizona's taxable capital gains would grow from $6.6 billion in TY 2008 to $9.7 billion in TY 2014. Based on national IRS data, it was further assumed that 58% of total capital gains accrue from investment in business. Other IRS data on business assets suggests that slightly less than 4.6% of these capital gains accrue from investment in qualifying small business (firms with assets not exceeding $10 million) determined by ACA.

Phase-Down of Corporate Income Tax Rate

This provision reduces the corporate income tax rate from 6.968% to 4.9% over 4 years, beginning in TY 2014. The reduction is estimated to result in a revenue loss of $(53.8) million in FY 2015 and grow to $(269.6) million in FY 2018, when the rate reduction is fully implemented. The FY 2015 estimate reflects the 4-sector consensus forecast and estimates beginning in FY 2016 reflect the 15-year average annual growth in corporate income tax collections.

Phase-In of Single Corporate Sales Factor

The provision increases the optional sales factor available to multi-state corporations from 80% to 100% in equal increments over a 4-year period, beginning in TY 2014. Based on DOR data, the increase in the corporate sales factor is expected to reduce corporate income tax collections by $(24.6) million in FY 2015 and $(84.0) million in FY 2018 when the provision is fully implemented. The estimate for this provision varies depending on the corporate tax rate in place during implementation. The above estimates include the phase-down of the corporate tax rate beginning in TY 2014. Without the tax rate provision, the phase-in of the single sales factor would reduce revenues by $(26.3) million in FY 2015 and grow to $(119.5) million in FY 2018.

Increase of University-Related R&D Credit

The research and development (R&D) credit is calculated based on the amount of qualified research expenses. This provision would increase the credit calculation by 10% for university-related research. The credit would be subject to an aggregate cap of $10 million per year. Since the current cost of the state's R&D program is about $40 million annually, it is assumed that this provision will raise this cost by 10%, or $4.0 million per year, beginning in FY 2013.

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Creation of a New Job Tax Credit

This provision provides a $3,000 annual tax credit for each net new qualifying job added by an employer in the state. To qualify for the $3,000 credit, which can be claimed for 3 years, the new employment position must: (1) be full-time, (2) pay at least the median wage, and (3) offer health insurance paid by the employer (at least 65% of premium). Additionally, a business cannot claim the new credit unless it adds at least 25 net new jobs in a year in an urban area (5 new jobs in rural area) and makes a capital investment of at least $5 million ($1 million in rural area). No employer is allowed to claim more than 400 jobs in the first year of credit use, 800 jobs in the second year, and 1,200 jobs in the third year. The bill provides a statewide aggregate credit cap of 10,000 jobs in FY 2013 ($30 million) and grows by an additional 10,000 jobs in both FY 2014 ($60 million) and FY 2015 ($90 million).

The cost of the credit is estimated to be $6.7 million for half a year in FY 2012, $13.4 million in FY 2013, and growing to $47.7 million in FY 2015. The estimates reflect applying the credit against baseline jobs. The baseline represents the "natural growth" in net new jobs, as forecast by the University of Arizona (UofA), which would occur regardless of the tax incentive. While UofA forecasts a net job gain of 79,200 positions in 2012, the bill's wage and health insurance requirements would reduce the number of credit eligible jobs to 29,700. The credit cap, along with the minimum net new employment and investment requirements, and other factors, such as insufficient tax liability and initial unawareness of the credit's existence, are estimated to further reduce the credit use to about 4,500 employment positions, for a cost of $13.4 million in FY 2013.

If this tax bill stimulates the creation of new jobs above the baseline forecast, the new job credit will have a greater cost. The cost of these "above the baseline" tax credits will be offset by the withholding and other related new taxes generated by these new jobs.

Elimination of Enterprise Zone Program

The bill would allow the state's Enterprise Zone program to sunset at the end of FY 2011, as currently scheduled. This program currently provides a tax credit for net new employment in certain designated areas within the state with high poverty and/or unemployment rates. Additionally, the program also assigns real and personal property in enterprise zones to Class 6 (5% assessment ratio) as opposed to Class 1 (20% assessment ratio). According to the most recent estimate provided by the Department of Revenue (DOR), the annual cost of the tax credit program is approximately $7 million. It is further estimated that about half of the annual credit use is from new credits and the remaining half from prior years' credit carry-forwards. Since the baseline forecast assumes that the Enterprise Zone program would have continued at the current level in future years, it is estimated that the repeal of the program would result in credit savings of $3.5 million, beginning in FY 2012. This figure represents the assumed carry-forward amounts used to offset tax liability after the program has ended, and after which no new credits will be created. Additionally, it also estimated that provision's repeal of the property tax incentive under the Enterprise Zone program will generate annual savings of $0.5 million, beginning in FY 2012. This means that the combined effect of the repeal of the income and property tax incentives will result in General Fund savings of $4.0 million, beginning in FY 2012. This estimate assumes that the school tax rate adjustments under the state's truth-in-taxation (TNT) provisions are allowed to take place.

Withholding Tax Diversion to Arizona Commerce Authority (ACA)

This provision would divert a portion of General Fund income tax to the Arizona Commerce Authority's Arizona Competes Fund and ACA's operating fund. Between the two funds, $31.5 million would be diverted from the General Fund in FY 2012. In addition, $3.5 million of lottery proceeds will be deposited into the Arizona Competes Fund. Total funding for the Arizona Commerce Authority will therefore initially be $35 million.