ARIZONA STATE SENATE

Fifty-Second Legislature, First Regular Session

FACT SHEET FOR H.B. 2083

income tax revisions

Purpose

Makes changes to statute based upon recommendations of the Joint Task Force on Income Tax Reform.

Background

The Joint Task Force on Income Tax Reform (Task Force) was established by the President of the Senate and the Speaker of the House of Representatives on August 15, 2013. The Task Force was charged with enhancing Arizona's business friendly profile and to make its tax system fairer for the average taxpayer, as well as exploring ways of reforming Arizona's existing personal income tax system in order to create a simple, predictable and transparent system for all Arizona taxpayers.

The Task Force held seven public meetings between August 21, 2013 and December 12, 2013 and produced a final report, which included the following recommendations:

Specific Legislative Income Tax Changes for 2014 Legislative Session

- Permanently increase instant expensing allowance to $500,000. The expensing provision would allow the cost of qualifying property to be treated as an expense rather than a capital expenditure and would apply to qualifying business equipment as defined in Internal Revenue Code (IRC) §179. The applicable investment ceiling limit would be $2,000,000. Thus, the expensing limit would be reduced dollar for dollar by the cost of qualified property placed in service during the tax year in excess of $2,000,000.
- Permanently increase bonus depreciation allowance to 50% to match the 2013 federal allowance for each future tax year (TY) for new equipment that is purchased and put into service the same TY the deduction is taken, which helps small businesses and therefore increases economic competitiveness.
- Index income tax brackets for inflation. Arizona Revised Statutes §43-1011 prescribes taxable income dollar amounts and rates for single and joint filers and does not account for inflation. Increases in income due to inflationary causes may move a taxpayer to a higher tax bracket, effectively causing a tax increase but without any real economic activity to show for that increase. The tax increase devalues the income for both small businesses and individual tax filers. An adjusted tax bracket reflecting changes in the Metropolitan Phoenix Consumer Price Index would increase fairness in the state IIT system by eliminating the annual inflationary tax increase upon small businesses and individual tax filers created by the current tax code.
- Reduce the IIT graduated-rate system from five to three income brackets. However, the effective date must be delayed until one year after the current tax brackets have been indexed for inflation. The delay will allow the inflation adjustment to compensate for any minimal

liability increase that may result from the reduction of the number of tax brackets. This change will thereby increase the fairness and simplicity of Arizona's IIT system.

- Allow businesses to E-file income tax returns with the Department of Revenue (DOR). All IIT tax returns may be filed electronically with DOR, however corporations are not currently able to E-file. Although the Task Force focused on IIT, E-filing across the board will promote fairness and simplicity amongst all taxpayers while increasing DOR efficiency.
- Reduce audit period from four years to three years. Currently, DOR has four years from the date a tax return is filed in which to audit and notify a taxpayer of tax adjustments. The task force recommends modifying the current audit period to three years for all notices of taxes due regarding IIT adjustments that are *not based on federal information* in the interest of fairness and simplification. Although the Task Force acknowledges the benefit of requiring a three-year audit period for all state audits, DOR does not receive federal taxpayer information until two years after the year a return is filed. Since over 95% of income tax audits are performed based on discrepancies between federal tax information and state income tax returns, the Task Force recommends DOR adopt a three-year audit period for errors that are based on state-level data only.
- Provide DOR with resources to build an up-to-date, sophisticated IIT model. The current DOR IIT model contains data from tax year 2006 grown out to tax year 2013. An up-to-date, sophisticated model would provide greater information and guidance to the Legislature when considering further tax reforms, thus increasing competitiveness and stability.
- Repeal the following obsolete tax statutes, which are all transitional provisions of the 1978 Arizona Income Tax Act:
  - A.R.S. §§ 43-1021 (4) and 43-1022 (8)
    - Provide different treatment of pensions where the first payment was received prior to December 31, 1978.
  - A.R.S. §§ 43-1021 (7) and 43-1022 (11)
    - Provide a different basis of property held for the production of income and which is sold or otherwise disposed of during the TY, except depreciable property used in a trade or business.
  - A.R.S. § 43-1022 (4)
    - Provides a subtraction for certain amounts distributed from an IRA or retirement plan of a self-employed individual to the extent that the total amount subtracted in all TYs does not exceed the total of all plan contributions made by the taxpayer prior to December 31, 1975.

According to a Joint Legislative Budget Committee (JLBC) fiscal note, this legislation is estimated to reduce the state General Fund as follows:

Table 1

General Fund Impact of HB 2083

($ in Millions)

Description	Tax	FY 2016	FY 2017	FY 2018
$500,000 Business Expensing	Individual & Corporate Income	$(30.8)	$(30.8)	$(30.8)
50% Bonus Depreciation	Individual Income	$(16.2)	$(16.2)	$(16.2)
Inflation Indexing Tax Brackets	Individual Income	$0.0 1/	$(15.4) 1/	$(24.7) 1/
Reducing DOR Audit Period (4 to 3 years)	Individual Income	$0	$0	$0
Total General Fund Impact		**$(47.0)**	**$(62.4)**	**$(71.7)**

1/ The Baseline includes a one-time revenue reduction of $(6.1) million for inflation indexing individual income tax brackets in TY 2015 (FY 2016), in accordance with Laws 2014, Chapter 10. The first year of impact for the provision then is TY 2016 (FY 2017).

Provisions

Statutes of Limitation for Audits

1. Requires any notice of additional tax due regarding individual income tax adjustments for taxable years beginning January 1, 2015, that are not based on federal information to be prepared on forms prescribed by DOR and mailed within three years after the report or return is required to be filed or within three years after the report or return is filed, whichever period expires later.

2. Permits an audit to be conducted for individual income tax changes or corrections based on federal information within the four year statute of limitations.

Income Tax Bracket Inflation Index

3. Requires DOR, for each taxable year beginning January 1, 2016, to adjust the income dollar amounts for each rate bracket according to the average annual change in the Metropolitan Phoenix Consumer Price Index.

4. Requires the revised dollar amounts to be raised to the nearest whole dollar.

5. Prohibits the income dollar amounts for each rate bracket from being revised below the amounts prescribed in the preceding taxable year.

Business Expensing and Bonus Depreciation

6. Allows a taxpayer, beginning in tax year 2015, to take an expense deduction to the amount allowed under federal law if the maximum deduction were $500,000, reduced by the amount exceeding $2 million.

7. Allows a taxpayer to deduct 10 percent of the amount of bonus depreciation allowed under federal law for tax year 2015 and stipulates such an election applies for the rest of the asset's life.

8. Allows a taxpayer to take a 50 percent bonus depreciation deduction for qualified property placed in service in taxable years beginning January 1, 2015.

9. Outlines necessary calculations regarding additions to Arizona gross income to avoid a double deduction if a taxpayer uses the business expensing or bonus depreciation provisions for and after TY 2015.

Repeal of Obsolete Language

10. Repeals obsolete statute regarding calculating additions and subtractions to Arizona gross income (A.R.S. §§ 43-1021(21) and 43-1022(20)(c)).

Miscellaneous

11. Makes technical and conforming changes.

12. Becomes effective on the general effective date with the retroactivity date as noted.

House Action

WM	1/26/15	DPA	8-1-0-0-0
APPROP	2/18/15	DPA	7-3-0-4-0
3rd Read	3/4/15		33-27-0-0-0

Prepared by Senate Research
March 9, 2015
BR/TW/ls