
History of Arizona's Individual Income Tax System

**Presentation to the
Joint Task Force on Income Tax Reform**

August 21, 2013

JLBC

Individual Income Tax (IIT) System Today

- Overview

- GF Revenue – Source of \$3.4 billion in '13. Made up 35% of Base Revenue

- Urban Revenue Sharing – 15% of collections from 2 years prior are distributed to cities and towns (\$430 M in '13)

- Who pays – In addition to individuals, IIT is collected from estates, trusts, and owners of pass-through entities
 - Pass-through entities include sole proprietorships, partnerships, limited liability companies, and S corporations

IIT System Today

- Calculating AZ IIT (TY 2011 Tax Abstract)

Federal Adjusted Gross Income (AGI) — \$135 billion

- Gross income less federal subtractions

Less: Sum of State-level Additions, Subtractions and Exemptions — \$(18) billion

Equals: Arizona AGI — \$117 billion

Less: Standard/Itemized Deductions and Personal Exemptions — \$(27) billion

Equals: Taxable Income — \$90 billion

IIT System Today

- Calculating AZ IIT (TY 2011 Tax Abstract)

*Multiply: Taxable income
by progressive rate schedule*

- (25)% rate reduction on long-term capital gains phased in 2013 to 2015

Equals: Tax Liability
– \$3 billion

Less: Tax Credits

Equals: Tax Due

(\$ in thousands)

<u>Single</u>	<u>Married</u>	<u>Rate</u>
\$0 to \$10	\$0 to \$20	2.59%
\$10 to \$25	\$20 to \$50	2.88%
\$25 to \$50	\$50 to \$100	3.36%
\$50 to \$150	\$100 to \$300	4.24%
\$150 and over	\$300 and over	4.54%

IIT System History

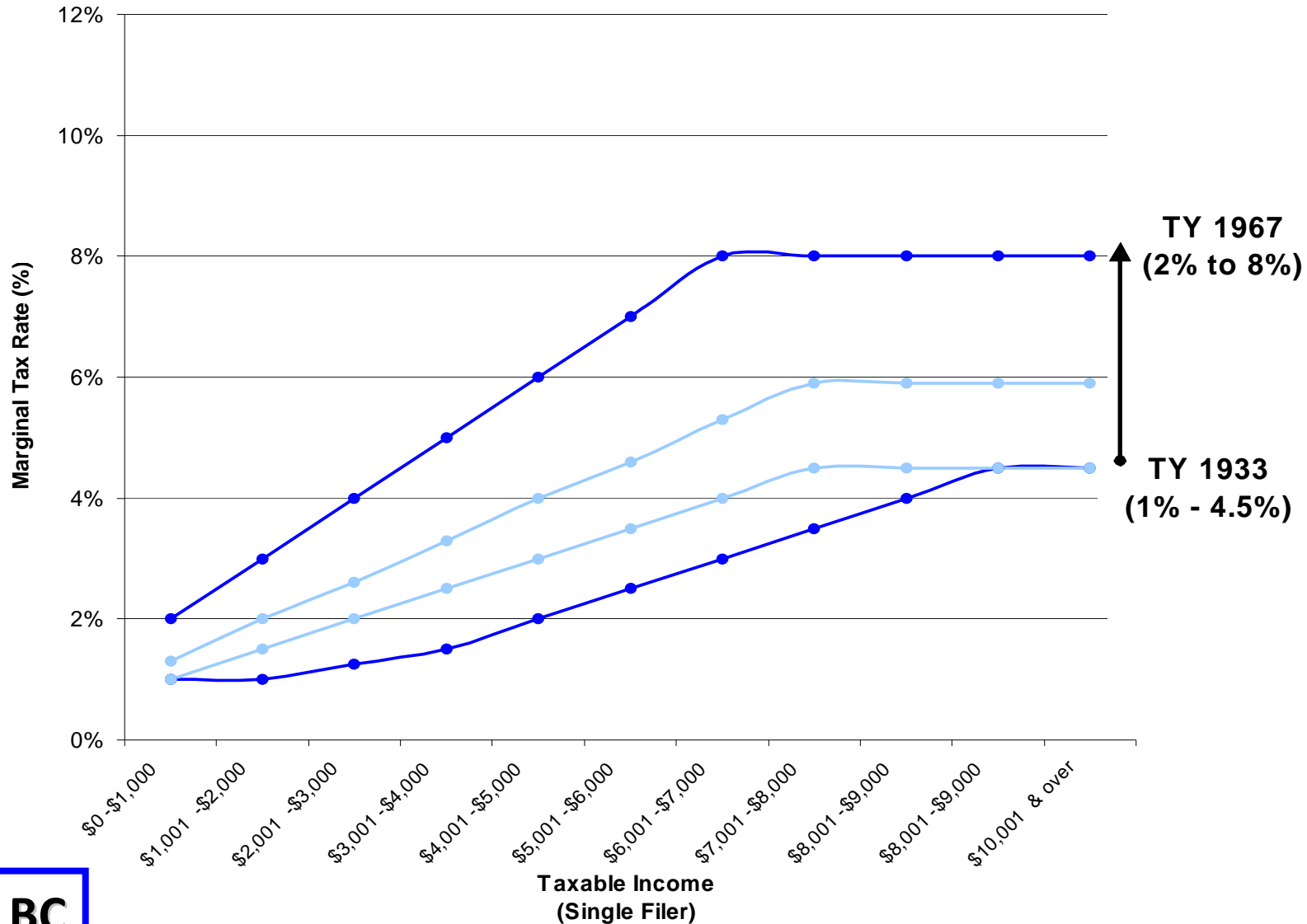
- Legislative Milestones

- 1933 – Established IIT
 - Property taxes insufficient in the Depression
 - AZ assessments fell 50% from 1929 to 1936
 - One of 18 states to enact IIT in response
 - Progressive rates (1% to 4.5%)
 - Net Taxable Income

- 1954 – Patterned state's system more closely with federal system
 - Added standard and itemized deductions and personal exemptions
 - Established a withholding payment system

IIT System History

- 3 Rate Increases from 1933 to 1967



IIT System History

- Legislative Milestones

- ❑ 1972 – Voter initiative established Urban Revenue Sharing for cities and towns
- ❑ 1973 – Creation of Arizona Department of Revenue; consolidated different agency tax functions
- ❑ 1978 – Furthers ties to federal system
 - New tax code
 - Federal AGI is starting point for AZ Gross Income
- ❑ 1979 – Taxation of S Corporations

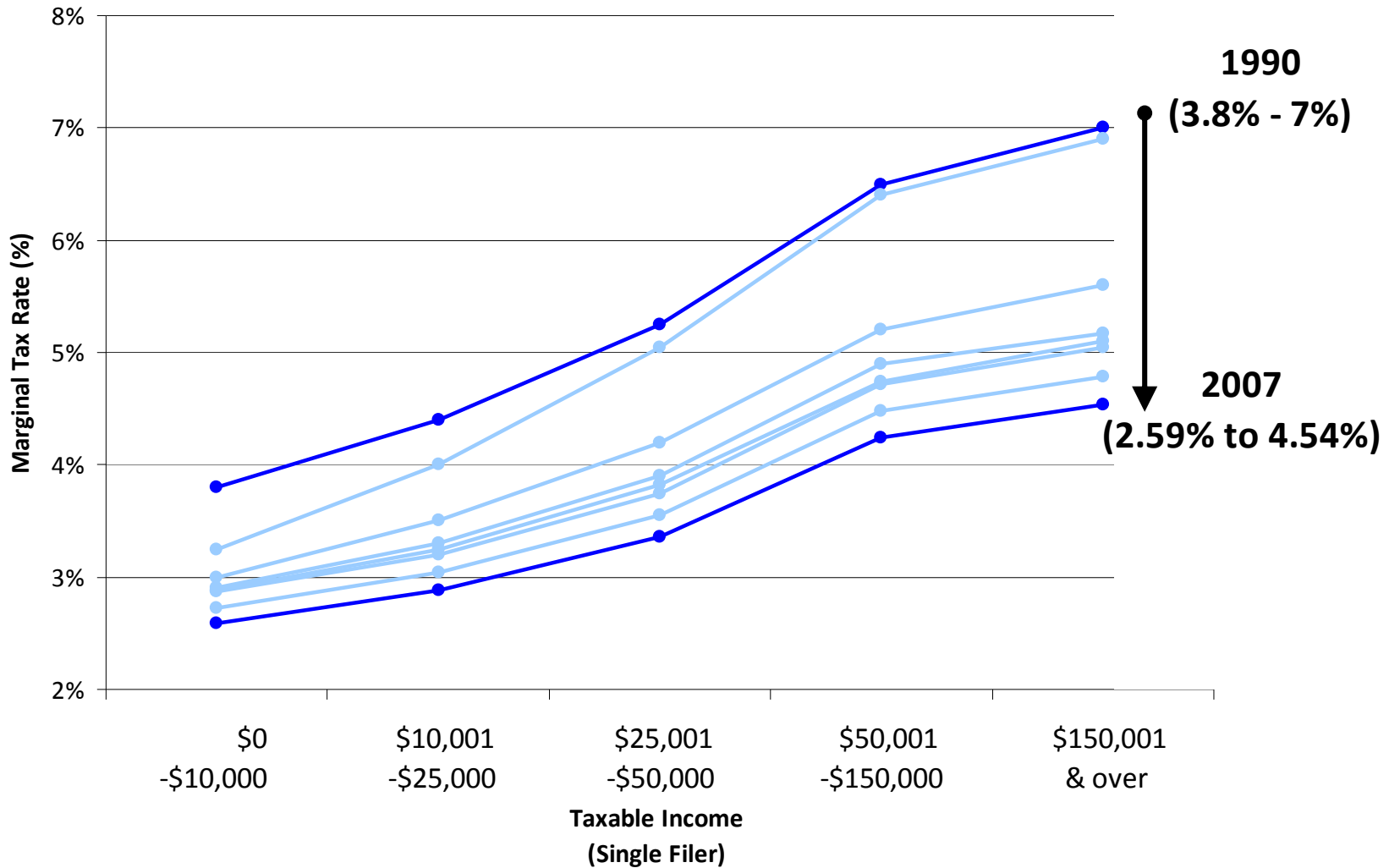
IIT System History

- Legislative Milestones

- ❑ 1983 – Required estimated payments
- ❑ 1990
 - Conformed to federal itemized deductions
 - Adjusted tax brackets to current levels
- ❑ 1992 – Established and taxed Limited Liability Companies
- ❑ 2012 – (25)% rate reduction for long-term capital gains

IIT System History

- 7 Rate Reductions from 1990 to 2007



IIT System History

- Tax Expenditures Overview

- ❑ Foregone revenues to the General Fund, cities, and towns
 - Federal and state subtractions
 - Exemptions
 - Standard and itemized deductions
 - Tax credits
- ❑ These items grew 7% annually from 1991 to 2006
 - Itemized deductions and tax credits made up 2/3 of the growth
 - Number of credits offered grew from 4 in 1991 to 24 in 2006 (30 offered in 2013)

IIT System History

- Largest Tax Expenditures in TY 2006

	TY 2006 (\$ millions)	Cumulative Percent
Home and Mortgage Interest	\$ 320.6	17%
Medical and Dental Expenses	\$ 197.9	28%
Standard Deduction	\$ 176.8	37%
State and Local Income Tax	\$ 153.6	45%
Charitable Contributions	\$ 116.0	51%
Personal Exemptions	\$ 351.3	70%
Other	\$ 563.8	100%
Total Tax Expenditures *	\$ 1,880.0	

*Does not include tax credits. More recent credit data is available on the next slide.

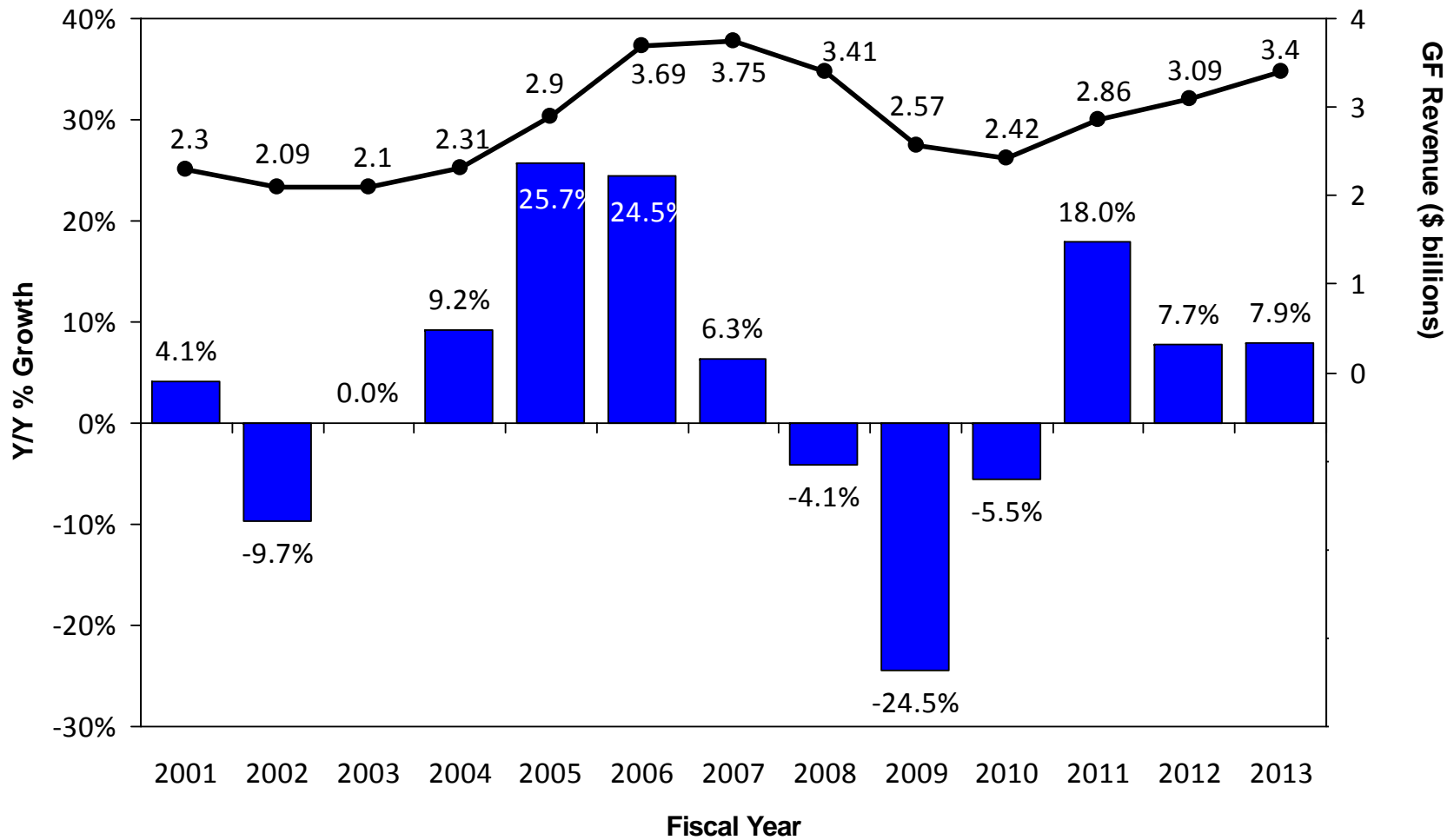
IIT System History

- Largest Tax Credit Expenditures in TY 2010

	TY 2010 (\$ in millions)	Cumulative Percent
Taxes to Other States/Countries	\$ 84.1	30%
Public School Extracurricular's	\$ 43.7	46%
Private School Tuition	\$ 43.2	61%
Low-income Credit (Prop 301)	\$ 35.3	74%
Charitable Org. Contributions	\$ 16.2	80%
Other Credits	\$ 56.0	100%
Total Tax Credits	\$ 278.5	

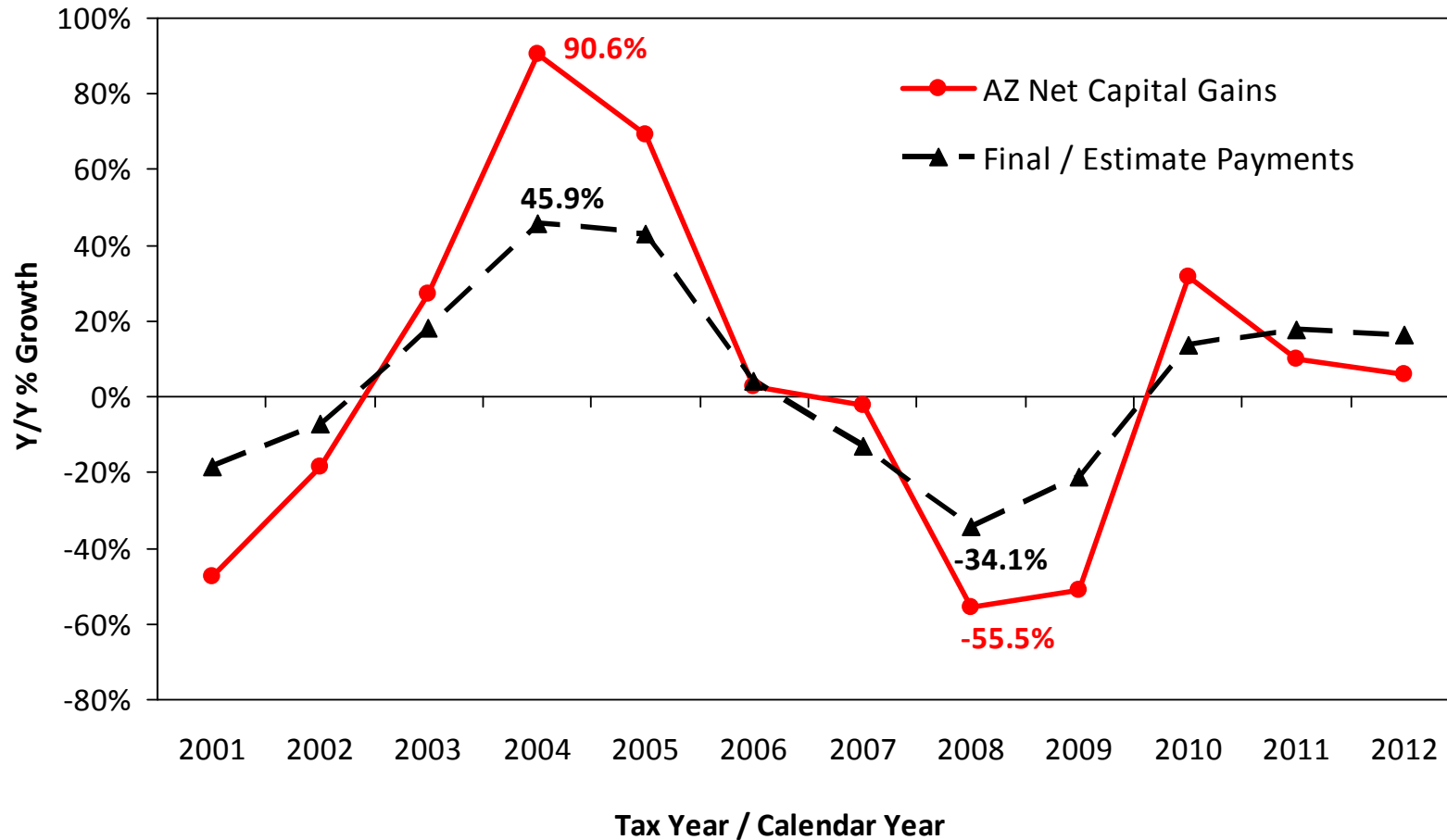
IIT Revenue Reliability

- Annual Growth of IIT GF Revenue



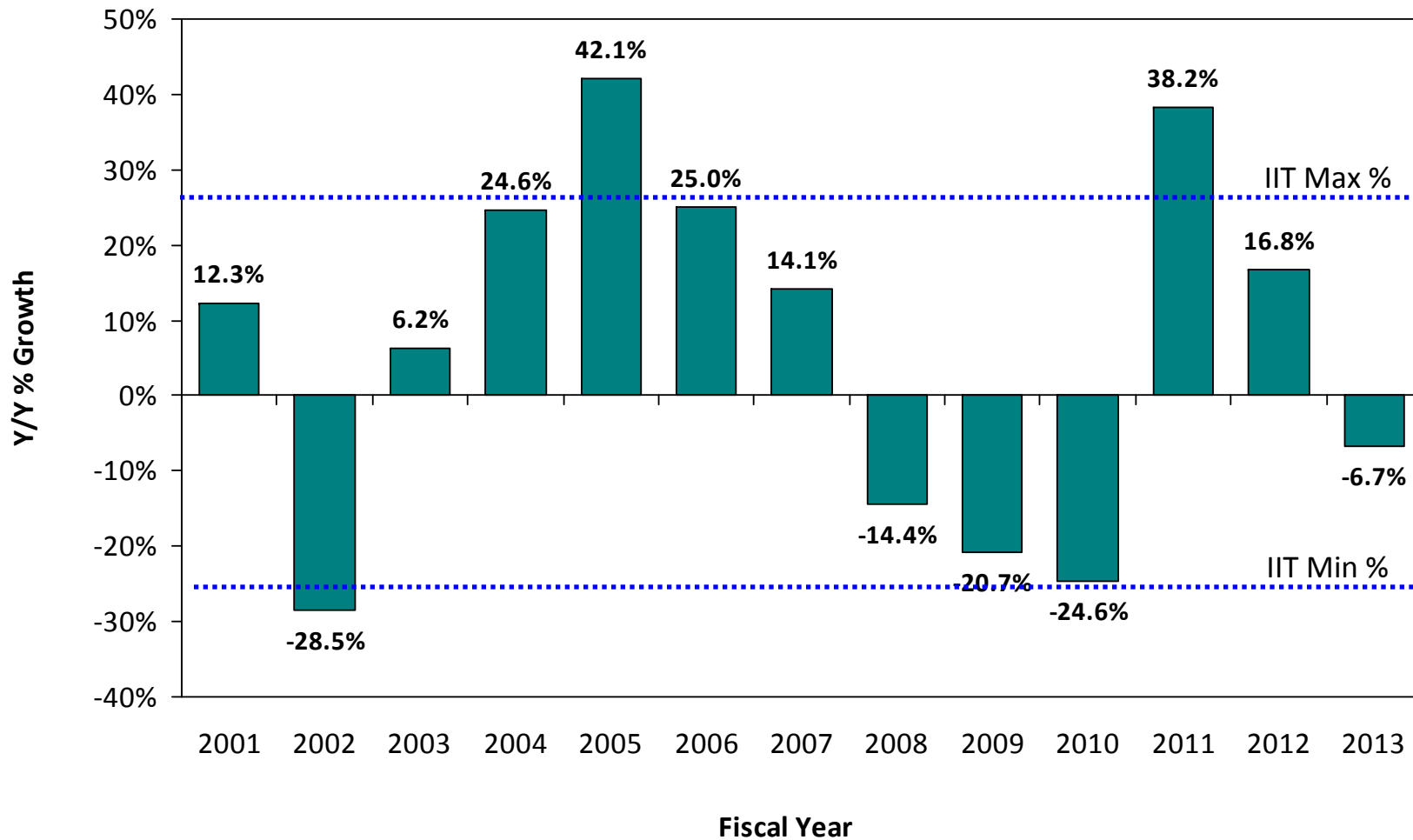
IIT Revenue Reliability

- Capital Gains is a Volatile Component of IIT



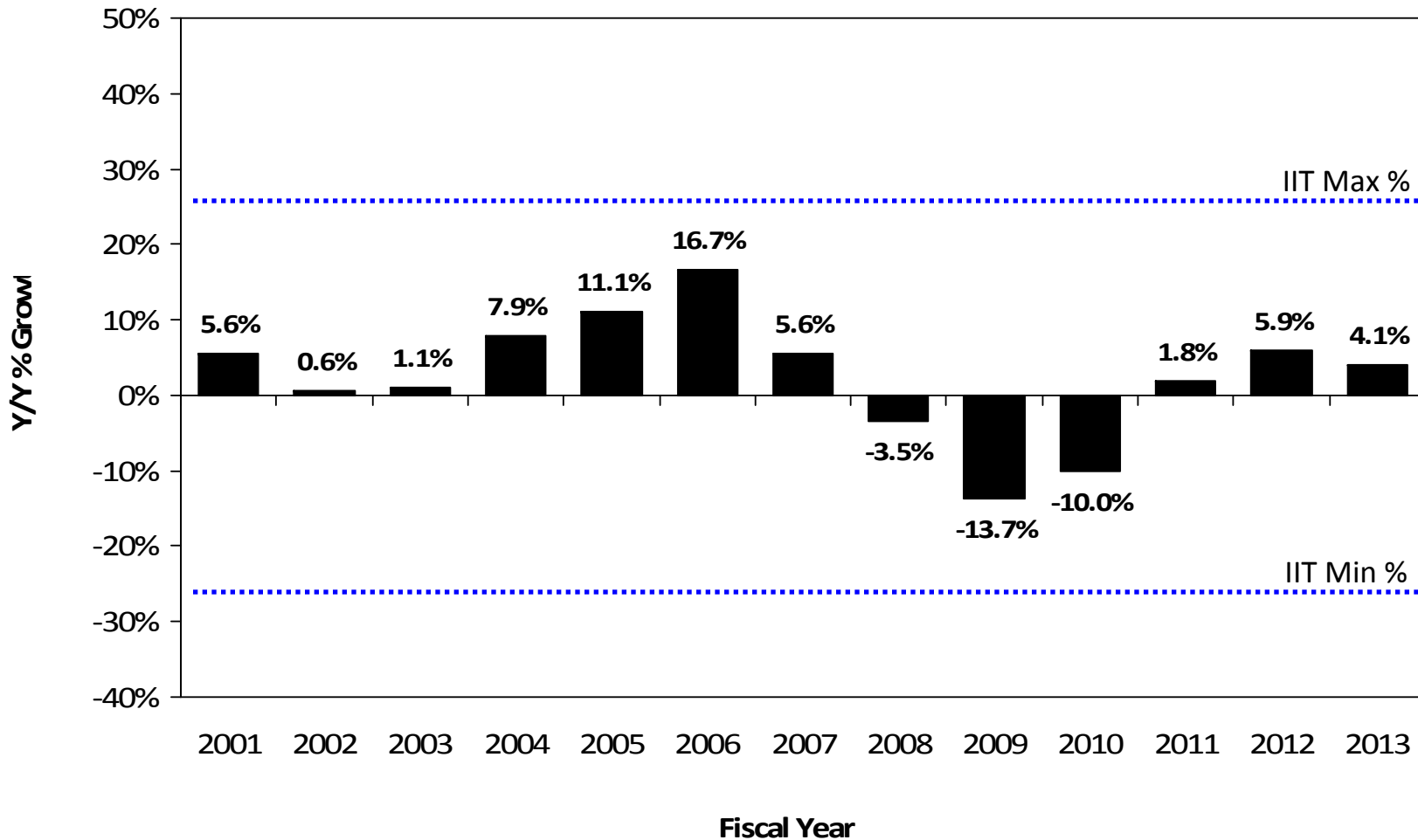
IIT Revenue Reliability

- Corporate Income Tax is More Volatile



IIT Revenue Reliability

- Transaction Privilege Tax is Less Volatile



JLBC Tax Handbook

<http://www.azleg.gov/jlbc/12taxbook/12taxbk.pdf>