Description

SB 1108, as introduced, would make several changes to property taxes, as well as individual and corporate income taxes. In addition, the bill includes other changes related to the taxation of vehicles using electricity, natural gas or propane, the Arizona Job Training Fund, and the Fire Assistance District tax rate cap. Please see attached detail for more information on the bill’s provisions.

Estimated Impact

As shown in the table below, the bill is estimated to have a General Fund cost of $66.1 million in FY 2022, $136.0 million in FY 2023, and $201.8 million in FY 2024.

<table>
<thead>
<tr>
<th>Description of Provision</th>
<th>Type</th>
<th>FY 2022</th>
<th>FY 2023</th>
<th>FY 2024</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) Imposes a new tax on vehicles propelled by electricity, natural gas or propane, beginning in FY 2022.</td>
<td>Vehicle Tax</td>
<td>1/</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3) Extends the repeal date of the Arizona Job Training Fund by 1 year to June 30, 2024. Remaining monies transferred to General Fund.</td>
<td>Revertment</td>
<td></td>
<td>2/</td>
<td></td>
</tr>
<tr>
<td>3) Phases down Class 1 assessment ratio from 18% to 17% over 2 years, beginning in TY 2022.</td>
<td>Property 3/</td>
<td></td>
<td>$(4.4)</td>
<td>$(9.0)</td>
</tr>
<tr>
<td>4) Sets the State Equalization Property Tax Rate (SETR) to $0.3461 in TY 2022 and $0.2745 in TY 2023.</td>
<td>Property 3/</td>
<td></td>
<td>(58.6)</td>
<td>(113.1)</td>
</tr>
<tr>
<td>5) Exempts 50% of income attributable to long-term capital gains from assets acquired after December 31, 2020.</td>
<td>Individual Income</td>
<td>0.0</td>
<td>(13.1)</td>
<td>(24.4)</td>
</tr>
<tr>
<td>6) Increases dependent tax credit from $100 to $120 if under age 17 and from $25 to $30 if age 17 or older, beginning in TY 2021.</td>
<td>Individual Income</td>
<td>(55.3)</td>
<td>(55.3)</td>
<td>(55.3)</td>
</tr>
<tr>
<td>7) Conforms state statutes to the federal bonus depreciation allowance for C Corporations, beginning in TY 2021.</td>
<td>Corporate Income</td>
<td>(10.8)</td>
<td>(4.6)</td>
<td>0.0</td>
</tr>
<tr>
<td>8) Increases the property tax rate cap for Fire Assistance Districts from $3.25 to $3.375 in TY 2022 and $3.50 in TY 2023.</td>
<td>Property 4/</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total General Fund Impact</strong></td>
<td></td>
<td>$(66.1)</td>
<td>$(136.0)</td>
<td>$(201.8)</td>
</tr>
</tbody>
</table>

1/ Increases Highway User Revenue Fund by $9.0 million annually, beginning in FY 2022
2/ Potential foregone General Fund revenue
3/ The state does not levy a property tax. The impact reflects the increased cost for state aid to K-12 school districts.
4/ While this provision increases the taxing capacity of a local taxing jurisdiction, it has no impact on the General Fund.
Description of Provisions in SB 1108

1) Impose New Tax on Vehicles Propelled by Electricity, Natural Gas or Propane
The bill would impose a new annual tax of $110 on each vehicle in the state propelled by electricity, natural gas or propane, beginning in FY 2022. For hybrid vehicles using a combination of electricity and either regular motor fuel (gasoline or diesel), natural gas, or propane, or a combination of regular motor fuel and natural gas or propane, the new tax would be $44 per year.

According to data from the Arizona Department of Transportation (ADOT), there are 34,898 electric vehicles in Arizona. While ADOT records no data on hybrid vehicles, the most recent data from the federal Energy Information Administration (EIA) suggests that 1.8% of the nation's 241 million vehicles are hybrid vehicles. Applying the same proportion to Arizona's estimated 6.4 million motorized vehicles, we estimate that there are about 114,400 hybrid vehicles in the state. Based on these assumptions, we estimate that the new tax on electric and hybrid vehicles would generate an estimated $8.9 million annually, beginning in FY 2022.

Data from EIA suggests that in 2017 approximately 649 vehicles in the state were fueled by natural gas and 190 vehicles by propane. Assuming these numbers have grown at the same rate as Arizona's population since 2017, we estimate that there are currently 680 natural gas vehicles, and 200 propane vehicles in the state. Based on this information, we estimate that the new tax on vehicles propelled by natural gas or propane would generate approximately $96,800 annually, beginning in FY 2022.

In summary, the new tax on vehicles (regular or hybrid) propelled by electricity, natural gas or propane would generate an estimated $9.0 million annually, beginning in FY 2022. The monies from this new tax would be deposited in Highway User Revenue Fund (HURF).

2) Extend the Repeal Date of the Arizona Job Training Fund
The Arizona Job Training Fund was created for the purpose of providing training and retraining for specific employment opportunities with new or expanding businesses in the state. Through December 31, 2015, monies from a tax on each employer of the state at a rate of 0.1% of the first $7,000 in taxable wages, were deposited into the fund. After the repeal of this tax, the fund's source of revenue has been legislative appropriations, gifts, grants and interest earnings. The Arizona Job Training Fund was originally scheduled to be repealed on July 1, 2017.

Laws 2017, Chapter 307 retroactively extended the fund's repeal date to June 30, 2022. SB 1108 would delay the repeal date by 2 years, to June 30, 2024. Any monies remaining in the fund on June 30, 2024 would be transferred to the General Fund. The amount to be reverted to the General Fund would depend on the balance in the fund on June 30, 2024.

The Arizona Commerce Authority is expecting the fund to have a minimal balance by the end of FY 2024. Due to the prior extension and uncertainty whether the fund would be repealed in June 2022, the FY 2024 Baseline does not include these revenues. As a result, the 2-year delay would not result in a loss of revenue relative to the Baseline.

3) Phase down the Assessment Ratio for Class 1 (Commercial) Property from 18% to 17%
Under current law, the assessment ratio for Class 1 (commercial) property is 18%. The bill would reduce the Class 1 assessment ratio to 17.5% in TY 2022 and 17% in TY 2023 and future years. Based on current Baseline projections, this change is estimated to result in a statewide net assessed valuation (NAV) reduction of $(669.2) million in TY 2022 and $(1.39) billion in TY 2023. Under the state's K-12 Basic State Aid (BSA) funding formula, a NAV loss of such magnitude would increase the BSA formula cost by $24.6 million in FY 2023 and $51.1 million in FY 2024. However, under the state's Truth in Taxation (TNT) provision for equalization assistance to schools, the Qualifying Tax Rate (QTR) and State Equalization Tax Rate (SETR) are automatically increased to ensure the same amount of property tax levies. Therefore, due to the automatic TNT adjustments of the QTR and SETR, there would be no impact on Basic State Aid.

The higher QTR resulting from the NAV reduction would increase the General Fund cost of the Homeowner's Rebate program by an estimated $4.4 million in FY 2023 and $9.0 million in FY 2024. Under the Homeowner's Rebate program, owners of Class 3 (owner-occupied residential) property effectively receive a credit or rebate from the state of up to $600 of their primary school district tax liability.

(Continued)
4) State Equalization Tax Rate (SETR) Set at $0.3461 in TY 2022 and $0.2745 in TY 2023
Under the Baseline, the State Equalization Property Tax Rate (SETR) is projected to decrease from $0.4426 in FY 2021 to $0.4297 in FY 2022, $0.4193 in FY 2023, and $0.4111 in FY 2024. (Property tax rates are levied per $100 of NAV.) The rate reductions under the Baseline reflect the automatic TNT adjustments discussed above. The NAV loss resulting from the Class 1 assessment ratio described above would result in a smaller TNT adjustment than under current law. For this reason, the SETR would be an estimated $0.4230 in FY 2023 and $0.4184 in FY 2024 (or relative to current law, $0.0037 higher in FY 2023 and $0.0073 higher in FY 2024). The bill would reduce the SETR to $0.3461 in FY 2023 and $0.2745 in FY 2024. At these rates, the JLBC Staff estimates that Class 3 (residential) property owners as well as owners of other non-Class 1 property on average would be held harmless from the primary property tax shift that would otherwise occur due to the Class 1 assessment ratio reduction. We further estimate that at these rates there would be an additional property tax reduction of $(7.3) million statewide (over and above what would be required to hold non-Class 1 property harmless).

The SETR under the bill would be $(0.0732) and $(0.1366) lower in FY 2023 and FY 2024, respectively, than under current law. At these rates, the SETR levy is estimated to be $(58.6) million less in FY 2023 than under current law. The corresponding SETR levy reduction in FY 2024 is estimated to be $(113.1) million. To provide the same funding for schools, such a loss of "local share" funding is made up by a commensurate increase of "state share" funding under the K-12 Basic State Aid formula. Therefore, this provision is estimated to result in a General Fund cost increase of $58.6 million in FY 2023 and $113.1 million in FY 2024.

5) Exempt 50% of Long-Term Capital Gains on Assets Acquired after 12/31/2020 from Individual Income Tax
Under current law, 25% of long-term net capital gains derived from assets acquired after December 31, 2011 is exempt from the state individual income tax. The bill would increase the long-term capital gains exemption from 25% to 50% on assets acquired after December 31, 2020. This means that relative to current law, the bill would provide an additional capital gains subtraction of 25% on assets acquired after 2020. As an example, an asset acquired in 2021 and sold at gain in 2023 would essentially qualify for both the 25% subtraction allowed under current law and the additional 25% provided under the bill, for a total capital gains subtraction of 50%. By contrast, if the same asset was purchased in 2019 instead, and sold at gain in 2023, it would only qualify for the current 25% capital gains reduction.

The current capital gains exemption that applies to assets acquired after December 31, 2011 was phased in over 3 years, such that it allowed a 10% subtraction in TY 2013, followed by a 20% subtraction in TY 2014, and 25% subtraction in TY 2015 and subsequent years. Data provided by the Department of Revenue (DOR) indicates that the 10% subtraction provided in TY 2013 reduced General Fund revenue by $(2.6) million, whereas the 20% reduction in TY 2014 resulted in a revenue loss of $(11.3) million. When the 25% subtraction was fully phased in the following year (TY 2015), the revenue impact was $(16.8) million. Thus, if the 25% subtraction had been in place in TY 2013 and TY 2014, the revenue impact would instead have been $(6.6) million in FY 2023 and $(14.1) million in FY 2015.

Our analysis assumes a similar "impact trajectory" under the bill's additional 25% capital gains subtraction. However, since the level of capital gains is twice higher now than in the period from TY 2013 through TY 2015, we have estimated the additional revenue loss under the bill to be $(13.1) million in FY 2023 and $(24.4) million in FY 2024. The revenue loss under the bill would continue to grow in the following years.

(As a technical note, the provision would have no revenue impact until FY 2023 as assets acquired in 2021 must be held for at least 1 year to qualify as long-term capital gains and to gain the additional 25% subtraction. As an example, an asset purchased in June 2021 and sold at gain in September 2022 would qualify as long-term capital gain on the individual's TY 2022 tax return. This return would be filed in the spring of 2023 and therefore the capital gains subtraction would not affect General Fund revenue until FY 2023.)

6) Increase of the Dependent Tax Credit from $100 to $120 and from $25 to $30
Laws 2019, Chapter 273 created a dependent tax credit, beginning in TY 2019. The credit is currently $100 for each dependent who is under 17 years old. The credit for each dependent who is age 17 or older is $25. The bill would raise the credit amount from $100 to $120 for the first category of dependents and from $25 to $30 for the second category, beginning in TY 2021. Since this type of analysis requires detailed tax-filing data, we asked the Department of Revenue to estimate the impact using their individual income tax simulation model. Based on their model, this provision is estimated to result in an annual revenue loss of $(55.3) million, beginning in FY 2022.

(Continued)
7) Allow Bonus Depreciation for Corporations
The bill would conform state statutes to federal bonus depreciation allowance for C corporations, beginning in TY 2021. Under current law, the federal bonus depreciation deduction is limited to individual income tax filers, such as shareholders of S corporations or partners in Limited Liability Companies.

The federal Tax Cuts and Jobs Act (TCJA) was enacted in December 2017. TCJA increased the bonus depreciation allowance from 40% to 100% in TY 2018, from 30% to 100% in TY 2019, and from 0% to 100% in TY 2020 through TY 2022. Beginning in TY 2023, the bonus depreciation allowance is reduced by 20% each year until it decreases to 0% in TY 2027.

Based on the prorating of federal revenue estimates published by the federal Joint Committee on Taxation (JCT), we estimate that conforming state statutes to the federal bonus depreciation allowed under TCJA would reduce state corporate income tax revenues by $(10.8) million in FY 2022, $(4.6) million in FY 2023, and $0 in FY 2024.

Our estimated impact of this provision is highly uncertain for the following reasons. First, the estimate of the federal revenue impact was prepared by JCT prior to the enactment of TCJA in 2017 and since we do not have access to corporate tax return data, we are not able to evaluate the accuracy of this estimate. Second, JCT’s estimate reflects 100% bonus depreciation at the federal level from the 4th quarter of TY 2017 through TY 2022, followed by a gradual phase-down to 0% over the next 5 tax years. At the state level, however, 100% bonus depreciation would not start until TY 2021, or toward the latter part of the period before the phase-down begins. JCT’s estimate reflects the change in investment behavior that followed the enactment of 100% bonus depreciation in 2017. Therefore, prorating JCT’s 2017 federal estimate to obtain a state estimate in TY 2021 adds more uncertainty to our estimate.

Finally, we would note that our analysis does not reflect any potential behavioral responses of businesses and individuals to the changes under the bill. For example, all else equal, a decrease in property and income taxes can serve as an incentive for businesses to employ more capital and labor, and individuals, to spend and invest more than they would otherwise. Such "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.

8) Increase the Property Tax Rate Cap for Fire Assistance Districts
Under current law, the County Fire Assistance District tax rate is capped at $3.25 per $100 net assessed valuation (NAV). Under the bill, the tax rate cap would be increased to $3.375 per $100 NAV for TY 2022 and $3.50 per $100 NAV for TY 2023 and each year thereafter. Since the County Fire Assistance District Tax is a secondary property tax, this provision would have no impact on the General Fund.

2/5/2021