Fiscal Note

BILL # SB 1109

TITLE: individual income tax; rate adjustment

SPONSOR: Mesnard

STATUS: Senate Engrossed

PREPARED BY: Benjamin Newcomb

Description

The bill would require the Joint Legislative Budget Committee (JLBC) to compute an individual income tax reduction amount each fiscal year based on the following three-part process:

1) Compare the state's projected ongoing General Fund revenues in the upcoming fiscal year to a "growth limit". The growth limit would reflect the state's ongoing FY 2021 General Fund revenue collections, as adjusted for the annual change in inflation plus population growth from the prior calendar year.
2) If ongoing revenues exceed the growth limit, the JLBC would then calculate the "structural surplus" for the upcoming fiscal year. The structural surplus would reflect the difference between ongoing General Fund revenue and ongoing General Fund spending.
3) JLBC would then multiply the structural surplus by 50% to compute the dollar value of the individual income tax reduction. The Department of Revenue (DOR) would then reduce the state's individual income tax rates to implement a tax reduction of that dollar value.

The bill's initial calculation schedule would occur as follows. During FY 2022, JLBC would implement the required 3-part calculation based on projected FY 2023 data. DOR would then implement the tax reductions for Tax Year (TY) 2022, which would impact FY 2023 revenue collections.

Estimated Impact

The bill would generate tax reductions if General Fund revenues grow faster than inflation and population. Under the January 2021 JLBC Baseline Forecast, we do not expect this threshold to be met. As a result, we estimate the bill will not have a fiscal impact during the state's current 3-year budget planning period (FY 2022 – FY 2024). This is largely due to a relatively high FY 2021 starting point for the bill's growth limit calculations. Due to the deferral of individual income tax (IIT) collections from April 2020 to July 2020, FY 2021 will have 2 main IIT filing periods. As a result, FY 2022 ongoing revenues are expected to be less than FY 2021.

FY 2022 revenues are estimated to be $(560) million below the growth limit. (*See Table 1 below*). Since the projected overall revenue growth of 4.4% in FY 2023 and 4.3% in FY 2024 would be higher than the combined projected population/inflation factor for each year, the gap between the growth limit and projected revenues declines. However, projected revenues would still remain below the growth limit.

Analysis

Based on the JLBC Baseline (JLBC Staff revenue forecast version), the state is expected to have ongoing revenues of $13.32 billion in FY 2021, $13.27 billion in FY 2022, $13.85 billion in FY 2023, and $14.45 billion in FY 2024. The figures are prior to deductions for Urban Revenue Sharing.

The bill establishes a "growth limit" which would reflect the state's ongoing FY 2021 General Fund revenue collections, as adjusted for the annual change in inflation plus population growth from the previous calendar year. The rate of inflation would be calculated using the Metro Phoenix consumer price index (CPI), as determined by the U.S. Bureau of Labor Statistics (BLS). The rate of population growth would be calculated using total state population, as determined by the U.S. Census Bureau.

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Arizona's population grew by 1.78% in 2020, according to the U.S. Census Bureau. We use IHS Markit data to forecast Arizona population growth of 1.19% for 2021 and 1.26% for 2022. The Metro Phoenix CPI increased by 2.00% in 2020, according to the U.S. Bureau of Labor Statistics. IHS Markit projects a Metro Phoenix inflation rate of 2.15% for 2021 and 2.42% for 2022.

The sum of the population and inflation components results in the growth limit increasing by the following percentages during the 3-year budget planning period: 3.78% for FY 2022, 3.34% for FY 2023, and 3.68% for FY 2024.

In FY 2021, ongoing revenues are projected to be $13.32 billion. After multiplying this level by the growth factors of 3.78%, 3.34%, and 3.68%, the projected growth limit under the bill is expected to be: $13.83 billion in FY 2022, $14.29 billion in FY 2023, $14.81 billion in FY 2024. As noted above, the growth limit would begin to affect potential tax reductions starting with calculations using FY 2023 data.

Table 1 below compares the JLBC Baseline revenue forecast to the bill's calculated growth limit for each year.

Table 1

Potential Fiscal Impact of SB 1109

($ in Millions)

	FY 2021	FY 2022	FY 2023	FY 2024
Baseline Ongoing Revenue	$13,321	$13,265	$13,848	$14,449
"Growth Limit" Amount	13,321	13,825	14,287	14,813
Revenues Above/(Below) Limit	--	(560)	(439)	(364)

Local Government Impact

Because the state's ongoing revenues are not projected to exceed the bill's growth limit during the current 3-year budget planning period (FY 2022 – FY 2024), the bill is expected to have no fiscal impact in that time period. If ongoing revenues surpass the growth limit in FY 2025 or later, and if there is a projected structural surplus, the bill's initial fiscal impact would be a reduction in General Fund revenue equal to 50.0% of the structural surplus.

Incorporated cities and towns receive 15% of state income tax collections from 2 years prior from the Urban Revenue Sharing Fund (URSF) established by A.R.S. § 43-206. Any individual income tax reductions implemented by the bill would therefore reduce URSF distributions to cities and towns. Because the bill is not projected to implement any tax reductions during FY 2022 – FY 2024, the bill is also estimated to have no fiscal impact for the URSF through FY 2026.

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