Fiscal Note

BILL # HB 2497 **TITLE:** income tax; rates; reduction

SPONSOR: Hoffman **STATUS:** As Introduced

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Description

The bill would implement a single Individual Income Tax rate of 2.5% for all levels of taxable income, beginning in Tax Year (TY) 2022. Starting in TY 2023, the bill would reduce the single income tax rate to 1.5%. These tax rates would also apply to the income of estates and trusts.

Under HB 2497, the state's 4.5% maximum tax rate policy would continue to apply. For income levels subject to the Proposition 208 surcharge ($250,000 single/$500,000 married), the General Fund would receive 1.0% and the Student Support and Safety Fund would receive the 3.5% surcharge.

In addition, the bill would modify the state's small business alternative income tax rate, reducing that tax rate to 2.5% in TY 2022. Starting in TY 2023, the alternative income tax rate would be reduced to 1.5%.

Estimated Impact

Compared to the JLBC Baseline, the bill is expected to reduce General Fund revenues by $(516.3) million in FY 2023, $(2.22) billion in FY 2024, and $(2.06) billion in FY 2025.

The bill is not projected to impact revenues to the Student Support and Safety Fund. While HB 2497 modifies the small business alternative income tax rate, the bill does not modify the definition of income eligible to be reported under the alternative system. Under both current law and HB 2497, the alternative tax rate is below the state's 4.5% maximum tax rate policy for standard income tax. We assume that taxpayers would continue to maximize the level of income shifted to the alternative tax system, subject to the existing income category restrictions (which are unchanged in the bill).

The estimates above do not reflect any offsetting "dynamic" revenue impact associated with the potential behavioral response of individuals and businesses to the proposed tax legislation. To the extent that a reduction in tax liability incentivizes greater investment and generates more economic activity, for example, some of the revenue loss may be offset.

Analysis

JLBC Baseline
The outcome of a referendum and litigation could affect the availability of General Fund resources in the next several years. To avoid overstating the availability of resources, the JLBC Baseline is based on a "maximum commitment" scenario. The JLBC Baseline assumes that: 1) Proposition 208 is upheld in litigation; and 2) The enacted income tax reductions, including the triggers, go into effect. Under the Baseline, the Individual Income Tax rates are as follows:

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Table 1			
JLBC Baseline Individual Income Tax Rates			
Income Level (Single/Married)	**<$27k/$55k**	**>$27k/$55k**	**>$250k/$500k**
TY 22/FY 23	2.55%	2.98%	4.5% [1% GF/3.5% Prop 208]
TY 23/FY 24	2.53%	2.75%	4.5% [1% GF/3.5% Prop 208]
TY 24/FY 25	2.5%		4.5% [1% GF/3.5% Prop 208]

HB 2497 Fiscal Impact

HB 2497 would implement the following Individual Income Tax rates:

Table 2		
HB 2497 Proposed Income Tax Rates		
Income Level (Single/Married)	**<$250k/$500k**	**>$250k/$500k**
TY 22/FY 23	2.5%	4.5% [1% GF/3.5% Prop 208]
TY 23/FY 24	1.5%	4.5% [1% GF/3.5% Prop 208]
TY 24/FY 25	1.5%	4.5% [1% GF/3.5% Prop 208]

In addition, HB 2497 would modify the state's small business alternative income tax rate as follows:

Table 3		
Small Business Alternative Income Tax Rates		
	Current Law	**HB 2497**
TY 22/FY 23	3.0%	2.5%
TY 23/FY 24	2.8%	1.5%
TY 24/FY 25	2.8%	1.5%

Compared to the JLBC Baseline, the bill is expected to reduce General Fund revenues by $(516.3) million in FY 2023, $(2.22) billion in FY 2024, and $(2.06) billion in FY 2025. These estimates are based on a Department of Revenue (DOR) Individual Income Tax model, with JLBC Staff adjustments to: 1) Use the assumed growth rates in the Baseline income tax forecast during FY 2023 – FY 2025; 2) Account for the Baseline's "maximum commitment" scenario assumptions on the tax triggers, as the DOR model typically only compares to a fixed base year; and 3) Account for the interactions across various tax provisions, such as the existing 4.5% maximum tax rate and the proposed alternative income tax rates, which are not included in the DOR model.

Local Government Impact

Beginning in FY 2024, incorporated cities and towns will receive 18% of individual and corporate income tax collections from 2 years prior from the Urban Revenue Sharing Fund (URSF) established by A.R.S. § 43-206. Therefore, the bill would decrease overall URSF distributions to cities and towns by the following estimated amounts:

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- FY 2025 – URSF distributions would be $(92.9) million lower than the JLBC Baseline
- FY 2026 – URSF distributions would be $(398.8) million lower than the JLBC Baseline
- FY 2027 – URSF distributions would be $(370.3) million lower than the JLBC Baseline

2/15/22