

# Fiscal Note

**BILL #** SB 1108

**TITLE:** income tax; credit; labor costs

**SPONSOR:** Rogers

**STATUS:** Senate Engrossed

**PREPARED BY:** Benjamin Newcomb

## REVISED

### Description

The bill would create an individual and corporate income tax credit employers could claim for increased labor costs stemming from a local minimum wage that is set above the state minimum wage. The credit would be equal to 10% of the difference between a business's actual wage base (i.e., total wages paid) and what its wage base would have been if all its employees were paid the state minimum wage. The credit is nonrefundable.

To reimburse the state for any General Fund revenue losses, cities and towns with higher local minimum wages would have their Urban Revenue Sharing (URS) distributions withheld from them equal to the amount of this credit claimed during the previous taxable year with certain exceptions. The bill would become effective beginning in Tax Year (TY) 2024.

We revised our analysis to remove public sector and non-profit employees from our calculations. The state and local minimum wage laws do not apply to public sector employees. While non-profits are covered by these laws, those entities would not receive the tax credit as they are tax-exempt. Our revised analysis only slightly changed our estimate of the General Fund revenue loss. But our revisions did substantially reduce the dollar value of unused credits.

### Estimated Impact

We estimate that the bill would have a General Fund net cost of \$(19.8) million in FY 2025 and \$(127.1) million in FY 2026. These estimates are based on the local minimum wage laws currently in place in the cities of Flagstaff and Tucson.

The dollar value of the earned tax credits is substantially greater than the revenue loss. Since the tax credit is not refundable, taxpayers can only take the credits to the extent that they have liability. The unused credit may be carried forward for 5 tax years. These unused credits are estimated to be \$117.1 million by FY 2026 (\$0.2 million from Flagstaff and \$116.9 million from Tucson).

The bill provides that the Treasurer will withhold URS distributions in the year after the taxable year in which the credit for increased labor costs is claimed. As a result, TY 2024 tax credit claims will occur in FY 2025 when employers are filing their taxes in the spring of 2025. The bill intends that the state be "paid" with lower URS distributions in Calendar 2025. The tax credits' losses, however, will not be known until after June 2025 due to the timing of tax filing. As a result, the tax loss will occur in FY 2025, but the URS withholding would likely not happen until FY 2026 (at some point after July 2025).

### Analysis

*Flagstaff Impact* - At \$16.80 per hour, Flagstaff is the only city in TY 2023 with a local minimum wage that is higher than the state minimum wage of \$13.85 per hour. The minimum wages for the state and for Flagstaff are adjusted annually based on the percentage change of the U.S. Consumer Price Index (CPI).

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Based on IHS Markit's most recent CPI forecast, we estimate that the state minimum wage will increase to \$14.28 in TY 2024 and \$14.57 in TY 2025. Flagstaff's local minimum wage is projected to increase to \$17.32 in TY 2024 and \$17.68 in TY 2025.

According to the U.S. Bureau of Labor Statistics (BLS), the total number of private-sector employees in the Flagstaff metropolitan area is 49,100. Based on the population of the city of Flagstaff relative to its entire metropolitan area, we estimate that there are 26,628 private-sector employees in the city itself. We then adjusted this number downward by 8% to exclude non-profit workers. The 8% factor is the statewide percent of Arizona employment in non-profit jobs. After this adjustment, we estimate that there are 23,623 private-sector employees in Flagstaff.

In 2022, Flagstaff workers worked an average of 32.4 hours per week (1,685 hours per year) at an average hourly rate of \$23.55, which equates to an average yearly wage of \$39,677, according to the BLS. Multiplying the number of private-sector employees by the average annual wage, we estimate that the total TY 2024 Flagstaff wage base is \$937.3 million [=23,623 workers x \$39,677 annual wage]. If these employees had been paid the state minimum wage, the total wage base would have been \$568.3 million [= 23,623 workers x 1,685 x TY 2024 \$14.28 state minimum wage]. This means that the TY 2024 increased labor cost under the bill would be \$369.0 million [= \$937.3 million - \$568.3 million]. Businesses in Flagstaff would be eligible to claim 10% of the increased labor costs in credits for TY 2024, or approximately \$36.9 million, which would be claimed when their TY 2024 tax returns are filed in the spring of 2025.

Using data from the U.S. Bureau of Economic Analysis (BEA) on proprietors' income and the state Gross Domestic Product (GDP), we estimate the combined TY 2024 corporate and individual income tax liability of Flagstaff businesses to be \$38.2 million. Since this amount is higher than the estimated \$36.9 million in earned credits under the bill, Flagstaff employers would be able to claim the full value of the credit in FY 2025.

Under current law, Flagstaff's URS distribution is estimated to be \$17.1 million in FY 2025. Under the bill, the State Treasurer would withhold this amount from Flagstaff.

The combined impact of the TY 2024 credit cost of \$(36.9) million and the \$17.1 million in URS distributions withheld from Flagstaff is a net General Fund loss of \$(19.8) million in FY 2025. This amount is projected to increase to \$(21.7) million in FY 2026.

*Tucson Impact* - The Tucson hourly minimum wage will increase to \$15.00 on January 1, 2025, and will be adjusted for inflation annually thereafter. Based on BLS data, we estimate there will be 149,571 qualifying Tucson private-sector employees after adjusting for the 8% non-profit factor. We estimate these employees earn an average annual wage of \$48,489. The average yearly hours worked in Tucson is 1,752, so we project the increase in hourly labor costs for Tucson employers to be \$3.43 billion [= (149,571 workers x \$48,489 average annual wage) - (149,571 workers x 1,752 hours x \$14.57 TY 2025 state minimum wage)]. This means that Tucson employers would be eligible to claim up to \$343.2 million in credits in TY 2025 (or FY 2026, for budgetary purposes).

While Tucson employers would earn a total of \$343.2 million in nonrefundable credits, they are only estimated to have a total of \$226.3 million in total corporate and individual income tax liability. Since the credit is nonrefundable, actual credit use by these businesses would therefore be limited to \$226.3 million out of the \$343.2 million in credits earned. The remaining \$116.9 million in unused credit may be carried forward for 5 years.

Under current law, Tucson's URS distribution is estimated to be \$120.8 million in FY 2026, which would be reduced by the same amount under SB 1108.

The net impact of the TY 2025 credit cost of \$(226.3) million and the \$120.8 million in URS distributions withheld from Tucson is a General Fund loss of \$(105.5) million in FY 2026. When the net Tucson impact is combined with the Flagstaff loss of \$(21.7) million, the statewide FY 2026 loss is \$(127.1) million.