

# Fiscal Note

**BILL #** SB 1260

**TITLE:** small businesses; income tax; rate

**SPONSOR:** Mesnard

**STATUS:** Senate Engrossed

**PREPARED BY:** Benjamin Newcomb

## Description

SB 1260 accelerates by 2 years the scheduled reduction of the Arizona small business income (SBI) tax rate to 2.5%. Under current law, the SBI rate is 2.8% in TY 2023 and TY 2024 before it is reduced to 2.5%, beginning in TY 2025. Under the bill, the SBI tax rate would be reduced to 2.5%, beginning in TY 2023.

At the proposed 2.5% rate, the SBI tax rate would match the TY 2023 regular Individual Income Tax (IIT) rate.

## Estimated Impact

We estimate that the bill would have a minimal impact on General Fund revenues in FY 2024 and FY 2025.

## Analysis

Laws 2021, Chapter 436 created an alternative income tax for certain classes of income, referred to as Arizona Small Business Income in statute. Individuals can choose to have such income taxed under either the regular IIT or the SBI tax. To qualify for the SBI tax, an individual's federal adjusted gross income must include one or more of the following income sources:

- Interest and Ordinary Dividends (Schedule B)
- Profit or Loss from Business (Schedule C)
- Supplemental Income or Loss (Schedule E)
- Profit or Loss from Farming (Schedule F)
- Sale of Business Property (Form 4797)
- Farm Rental Income and Expenses (Form 4835)
- Capital Gains and Losses with respect to the taxable disposition of an ownership interest in any business entity other than a publicly traded company, or the taxable disposition of capital assets used in connections with trade or business activity (Schedule D).

Under current law, the 2.8% SBI tax rate in TY 2023 and TY 2024 is higher than the 2.5% IIT rate, thereby offering no incentive for taxpayers with qualifying income to pay the SBI tax. As noted above, under the bill, the SBI rate would become 2.5% in TY 2023, identical to the IIT rate. As such, there would be little incentive for individuals to file income as SBI instead of as IIT. Therefore, we expect that the implementation of the 2.5% SBI rate 2 years earlier than scheduled under current law would have a minimal General Fund revenue impact in FY 2024 and FY 2025.

## 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 (URS) Fund established by A.R.S. § 43-206. Since SB 1260 is expected to have minimal income tax impact in FY 2024 and FY 2025, the bill would also have a minimal impact on URS distributions to cities and towns in FY 2026 and FY 2027.

3/15/23

