Fiscal Note

BILL # SB 1577

TITLE: income tax rate; reduction; surplus

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. The annual calculation would be based on the following 3-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 2023 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 single 2.5% tax rate to implement a tax reduction of that dollar value.

See the analysis section below for a description of the bill's initial calculation schedule.

Estimated Impact

The bill would generate tax reductions if General Fund revenues grow faster than inflation and population. Under the January 2023 4-Sector 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 2024 – FY 2026). This is largely due to issues related to the starting points of the bill's calculation: the state's projected revenue growth in FY 2024 is negative due to the implementation of the state's single 2.5% tax rate, while the bill's "growth limit" would increase significantly in FY 2024 based on using Calendar Year (CY) 2022 inflation data.

While the bill is not projected to have an impact in the next 3 years, we presume that General Fund revenues will grow faster than inflation and population at some point in the future. To give some perspective on the potential effect on the income tax rate, we have developed a sample scenario. If revenues exceed the growth limit and the state had a structural surplus of $200 million, 50% of that amount, or $100 million, would finance a reduction in individual income tax rates. Based on current income tax collections, the $100 million would reduce the income tax rate from 2.5% to 2.46%.

Analysis

The bill's initial calculation would occur for FY 2024 (which runs from July 1, 2023 through June 30, 2024), with JLBC implementing the required 3-part calculation as follows:

- JLBC would calculate the "growth limit" for FY 2024, which would equal FY 2023 ongoing revenue adjusted for the annual change in CY 2022 population growth and CY 2022 inflation.

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- The FY 2024 "growth limit" would be compared to the FY 2024 JLBC Baseline ongoing revenue forecast
- If the FY 2024 ongoing revenue forecast exceeded the FY 2024 growth limit, JLBC Staff would calculate 50% of the FY 2025 structural surplus, which is then designated as the "Arizona taxpayer return". DOR would then reduce the state's 2.5% single tax rate permanently starting in Tax Year (TY) 2024 to reduce income taxes by the magnitude of the "Arizona taxpayer return", which would impact FY 2025 revenue collections.

Based on the JLBC Baseline 4-Sector forecast, the state is expected to have ongoing revenues of $17.25 billion in FY 2023, $16.87 billion in FY 2024, $17.36 billion in FY 2025, $18.11 billion in FY 2026. The figures include enacted tax reductions and are prior to deductions for Urban Revenue Sharing.

The bill establishes a "growth limit" which would reflect the state's ongoing FY 2023 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.

Arizona's population grew by 1.30% in 2022, according to the U.S. Census Bureau. We use IHS Markit data to forecast Arizona population growth of 1.61% for 2023 and 1.44% for 2024. The Metro Phoenix CPI increased by 11.51% in 2022, according to the U.S. Bureau of Labor Statistics. IHS Markit projects a Metro Phoenix inflation rate of 3.77% for 2023 and 2.07% for 2024.

The sum of the population and inflation components result in the growth limit increasing by the following percentages during the 3-year budget planning period: 12.81% for FY 2024, 5.38% for FY 2025, and 3.51% for FY 2026.

In FY 2023, ongoing revenues are projected to be $17.25 billion. After multiplying this level by the growth factors of 12.81%, 5.38%, and 3.51%, the projected growth limit under the bill is expected to be: $19.46 billion in FY 2024, $20.51 billion in FY 2025, $21.23 billion in FY 2026. As noted above, the growth limit would begin to affect calculations using FY 2024 data, with any tax reduction impact starting in FY 2025.

Table 1 below compares the 4-Sector revenue forecast to the bill's calculated growth limit for each year.

Table 1

Potential Fiscal Impact of SB 1577
($ in Millions)

	FY 2023	FY 2024	FY 2025	FY 2026
Baseline Ongoing Revenue	$17,252	$16,869	$17,363	$18,110
"Growth Limit" Amount	--	19,463	20,509	21,227
Revenues Above/(Below) Limit	--	(2,594)	(3,146)	(3,117)

Local Government Impact

Beginning in FY 2024, incorporated cities and towns receive 18% 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 2024 – FY 2026, we estimate the bill would have no fiscal impact for the URSF through FY 2028.

2/22/23