Fiscal Note

BILL # SCR 1035

TITLE: surplus; income tax rate; reduction

SPONSOR: Mesnard

STATUS: Senate Engrossed

PREPARED BY: Benjamin Newcomb

Description

If approved by voters at the 2024 General Election, the resolution 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 2025 General Fund revenue collections, as adjusted for the annual change in inflation plus population growth from the prior calendar year (CY).
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 (IIT) 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 resolution would generate tax reductions if General Fund revenues grow faster than inflation and population. Under the January 2023 4-Sector Baseline Forecast, we project the growth limit to be exceeded in FY 2026. As a result, we estimate the resolution would reduce FY 2027 General Fund revenues by $(253.5) million, which is 50% of the projected FY 2027 structural surplus. Based on forecasted income tax collections, a reduction of that dollar magnitude would require DOR to reduce the state's single IIT rate from 2.5% to 2.4% in Tax Year (TY) 2026.

Analysis

The resolution's initial calculation would occur for FY 2026 (which runs from July 1, 2025 through June 30, 2026), with JLBC implementing the required 3-part calculation as follows:

- JLBC would calculate the "growth limit" for FY 2026, which would equal FY 2025 ongoing revenue adjusted for the annual change in CY 2024 population growth and CY 2024 inflation.
- The FY 2026 "growth limit" would be compared to the FY 2026 JLBC Baseline ongoing revenue forecast.
- If the FY 2026 ongoing revenue forecast exceeded the FY 2026 growth limit, JLBC Staff would calculate 50% of the FY 2027 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 TY 2026 to reduce income taxes by the magnitude of the "Arizona taxpayer return", which would impact FY 2027 revenue collections.

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Based on the JLBC Baseline 4-Sector forecast, the state is expected to have ongoing revenues of $15.97 billion in FY 2025 and $16.81 billion in FY 2026. These figures include enacted tax reductions and deductions for Urban Revenue Sharing (URS).

The resolution establishes a "growth limit" which would reflect the state's ongoing FY 2025 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.

We use IHS Markit data to forecast Arizona population growth of 1.44% for CY 2024. In addition, IHS Markit projects a Metro Phoenix CPI growth of 2.07% for CY 2024. The sum of the population and inflation components result in the growth limit increasing by 3.51% for FY 2026.

In FY 2025, ongoing revenues are projected to be $15.97 billion. After multiplying this level by the growth factor of 3.51%, the projected growth limit under the resolution is expected to be $16.53 billion in FY 2026. As noted above, the growth limit would begin to affect calculations using FY 2026 data, with any tax reduction impact starting in FY 2027.

Given this data, ongoing FY 2026 revenues of $16.81 billion are projected to exceed the FY 2026 growth limit of $16.53 billion. Therefore, under the resolution, JLBC Staff would then calculate 50% of the FY 2027 structural surplus (referred to as the "Arizona taxpayer return" in the resolution).

Since the JLBC Baseline revenue and spending projections do not extend into FY 2027, this analysis assumes that FY 2027 ongoing revenues and ongoing spending would increase by a standard annual growth rate of 4.5%. Using this method, the FY 2027 structural surplus would be $507.0 million, so the "Arizona taxpayer return" would be $253.5 million. Under the resolution, DOR would permanently reduce the IIT rate starting in TY 2026, which would reduce annual General Fund revenues by $(253.5) million starting in FY 2027. Based on forecasted income tax collections, a reduction of that dollar magnitude would require DOR to reduce the state's single IIT rate from 2.5% to 2.4% in TY 2026.

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. Therefore, under the resolution, URS distributions to cities and towns would decrease by $(45.6) million annually beginning in FY 2029.

3/1/23