Fiscal Note

BILL # SB 1371

TITLE: income tax; subtraction; retirement distribution

SPONSOR: Mesnard

STATUS: Senate Engrossed

PREPARED BY: Benjamin Newcomb

Description

The Senate Engrossed version of SB 1371 would subtract distributions from qualified retirement plans and Individual Retirement Accounts (IRA) for taxpayers aged 67 and older from the calculation of Arizona gross income (AGI).The value of the subtraction is limited to the same amount as the standard deduction each year. The bill would become effective retroactively from Tax Year (TY) 2025, affecting FY 2026 collections.

Estimated Impact

We estimate the bill would reduce General Fund revenue by $(130.4) million annually starting in FY 2026. Our estimate does not reflect the bill's potential dynamic effects, which are typically secondary to the direct impact. For example, all else being equal, exempting a large portion of retirement distributions from IIT may serve as an incentive for more retirees to move to the state, which would increase consumer spending that may result in greater economic output. If implementation of this bill would require lower state spending, taxpayers may lower their consumption, which may result in lower economic output.

Given the lower level of liability under the bill, taxpayers may qualify for a lower level of nonrefundable IIT credits.

We have asked the Department of Revenue (DOR) for their estimate of the bill's impact but have not yet received a response.

Analysis

Distributions from Pensions and Retirement Accounts

According to the most recent data from the Internal Revenue Service (IRS), taxable distributions from qualified retirement plans, such as an employer-sponsored 401(k) plan, and IRAs in Arizona were $10.37 billion in TY 2022. Based on the 5-year average annual growth in retirement distributions, which is 4.6%, we estimate this total will grow to $11.87 billion by TY 2025.

The Office of Economic Opportunity (OEO) produces low, medium, and high projections of Arizona's population by year through 2060 and includes estimates by age group. Based on the medium series, we estimate that of those aged 59.5 and older (the minimum eligible age to begin receiving distributions), 66.0% are at least 67 years old. Applying this percentage to the overall level of retirement distributions, we estimate that $7.83 billion of distributions would be eligible for the subtraction under the bill.

The value of the subtraction is limited to the same amount as the standard deduction each year. In TY 2025, these amounts are $15,000 for single filers, $22,500 for unmarried heads of household, and $30,000 for those married filing jointly. Using the most recent data from DOR on the distributions of filers and taxable income by filing status and applying them to our distribution estimate, we project that of the $7.83 billion of subtraction-eligible distributions, only $5.22 billion would be subtracted from AGI. Since the state's IIT rate is 2.5%, there would be a $(130.4) million annual decrease in income tax collections beginning in FY 2026.

Local Government Impact

Incorporated cities and towns 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 the bill would decrease statewide IIT revenue by $(130.4) million in FY 2026, overall URS distributions to cities and towns would decrease by $(23.5) million in FY 2028.

3/17/25