

Joint Legislative Budget Committee

Staff Memorandum

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DATE: June 24, 2021

TO: Richard Stavneak, Director

FROM: Hans Olofsson, Chief Economist

SUBJECT: DISTRIBUTIONAL IMPACT OF THE INCOME TAX RATES AND THE 4.5% RATE CAP UNDER SB 1828 AND SB 1827

This memo responds to requests that we have received for the distributional impact by income level of the individual income tax rates as well as the rate cap under the Senate Engrossed versions of SB 1828 and SB 1827, respectively. Under SB 1828, for Tax Year (TY) 2022, single filers pay a tax rate of 2.55% for taxable income of up to \$27,272 and 2.98% on taxable income above \$27,272. The income bracket for individuals filing as married couples or heads of household are twice that amount, or \$54,544.

Under SB 1828, further rate reductions beyond the 2.55%/2.98% rates in TY 2022 will be contingent upon the state receiving more General Fund revenue than forecast. Excluding the beginning balance, the "trigger" target is set at \$12.8 billion in FY 2022 and \$13.0 billion in FY 2023 and each year thereafter. If the state receives more than the FY 2022 trigger level, the rates will be reduced to 2.53%/2.75%, beginning in TY 2023. If the state receives more than \$13.0 billion in FY 2023 or any subsequent year, the rate will be reduced to a single 2.5% rate in the following Tax Year.

The distributional analysis also includes the impact of the 4.5% rate cap under SB 1827. Under this provision, the combined regular top marginal rate and the Proposition 208 surcharge is capped at 4.5% for taxable income above \$250,000/\$500,000, beginning in TY 2021. Absent the cap, the combined rate would be 6.48% in TY 2022.

On May 26, 2021, we published the distributional impact of the 2.5% rate proposal. That impact continues to appear in *Table 1* and *Table 2*. In this memorandum, we have now incorporated the distributional impact of the 2.55%/2.98% proposal in *Table 3* and *Table 4*.

The estimates in the tables below were produced by the Department of Revenue's (DOR) Individual Income Tax Microsimulation Model, which is based on a large sample of tax returns filed by Arizona residents.

We present the DOR information in 2 forms. The percentage reduction in total individual income tax liability for tax filers in 14 separate income groups, are shown in *Table 1* and *Table 3*. The average reduction (in dollars) for the same 14 income groups are shown in *Table 2* and *Table 4*.

Since the DOR model is a "static" rather than a "dynamic" model, their estimates do not account for several factors. First, the estimates do not reflect any offsetting "dynamic" revenue impact associated with the potential behavioral response of individuals and businesses to the proposed tax legislation. To the extent that a reduction in tax liability incentivizes greater investment and generates more economic activity, for example, some of the revenue loss may be offset.

Second, the estimates of the tax proposal are based on taxpayers' TY 2021 liability. As noted above, we utilized DOR's microsimulation model of more than 50,000 tax returns for the full implementation costs of the tax reduction, which tends to provide a more accurate assessment of the fiscal impacts.

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DOR uses TY 2021 liability as part of their model. This limitation understates the revenue loss since liability will be greater by the time that the 2.55%/2.98% rates are implemented in TY 2022 (FY 2023) and the 2.5% single rate in a future year.

Table 1

Individual Income Tax Liability by Income Level under 2.5% Single Rate and 4.5% Rate Cap
[Millions of Dollars]

A	B	C	D	E	F = E/C	G = E/D
<u>Federal AGI</u>	<u># Filers*</u>	<u>Prior to Prop 208</u>	<u>After Prop 208</u>	<u>Proposal**</u>	<u>% Change to Pre 208</u>	<u>% Change to Post 208</u>
< \$0	39,293	\$0.8	\$0.8	\$0.6	-19.3%	-19.3%
\$0 - \$10,000	306,442	\$7.0	\$7.0	\$6.4	-8.0%	-8.0%
\$10,000 - \$20,000	409,702	\$29.7	\$29.7	\$28.2	-5.2%	-5.2%
\$20,000 - \$25,000	195,464	\$37.6	\$37.6	\$36.1	-4.0%	-4.0%
\$25,000 - \$30,000	198,412	\$55.2	\$55.2	\$53.0	-4.0%	-4.0%
\$30,000 - \$40,000	344,807	\$154.3	\$154.3	\$148.3	-3.9%	-3.9%
\$40,000 - \$50,000	261,411	\$178.6	\$178.6	\$168.4	-5.7%	-5.7%
\$50,000 - \$75,000	449,967	\$483.6	\$483.6	\$440.6	-8.9%	-8.9%
\$75,000 - \$100,000	296,485	\$521.5	\$521.5	\$452.9	-13.2%	-13.2%
\$100,000 - \$200,000	418,814	\$1,368.8	\$1,368.8	\$1,092.1	-20.2%	-20.2%
\$200,000 - \$500,000	117,693	\$1,138.6	\$1,153.9	\$777.2	-31.7%	-32.6%
\$500,000 - \$1,000,000	18,405	\$472.9	\$561.7	\$338.4	-28.4%	-39.8%
\$1,000,000 - \$5,000,000	8,626	\$593.8	\$939.6	\$537.4	-9.5%	-42.8%
> \$5,000,000	<u>1,019</u>	<u>\$466.0</u>	<u>\$817.8</u>	<u>\$460.8</u>	<u>-1.1%</u>	<u>-43.7%</u>
TOTAL	3,066,540	\$5,508.2	\$6,309.9	\$4,540.3	-17.6%	-28.0%

* Includes residential filers only. DOR model does not provide distributional impact of nonresident filers.

** Proposal: 2.5% regular rate with combined regular/Prop 208 rate capped at 4.5% on taxable income above \$250,000/\$500,000.

Table 2

Average Individual Income Tax Liability by Income Level under 2.5% Single Rate and 4.5% Rate Cap

A	B	C	D	E	F = E - C	G = E - D
<u>Federal AGI</u>	<u># Filers*</u>	<u>Prior to Prop 208</u>	<u>After Prop 208</u>	<u>Proposal**</u>	<u>\$ Change to Pre 208</u>	<u>\$ Change to Post 208</u>
< \$0	39,293	\$20	\$20	\$16	(\$4)	(\$4)
\$0 - \$10,000	306,442	\$23	\$23	\$21	(\$2)	(\$2)
\$10,000 - \$20,000	409,702	\$72	\$72	\$69	(\$4)	(\$4)
\$20,000 - \$25,000	195,464	\$192	\$192	\$184	(\$8)	(\$8)
\$25,000 - \$30,000	198,412	\$278	\$278	\$267	(\$11)	(\$11)
\$30,000 - \$40,000	344,807	\$447	\$447	\$430	(\$17)	(\$17)
\$40,000 - \$50,000	261,411	\$683	\$683	\$644	(\$39)	(\$39)
\$50,000 - \$75,000	449,967	\$1,075	\$1,075	\$979	(\$96)	(\$96)
\$75,000 - \$100,000	296,485	\$1,759	\$1,759	\$1,527	(\$231)	(\$231)
\$100,000 - \$200,000	418,814	\$3,268	\$3,268	\$2,608	(\$661)	(\$661)
\$200,000 - \$500,000	117,693	\$9,674	\$9,805	\$6,603	(\$3,071)	(\$3,201)
\$500,000 - \$1,000,000	18,405	\$25,694	\$30,521	\$18,387	(\$7,306)	(\$12,133)
\$1,000,000 - \$5,000,000	8,626	\$68,834	\$108,923	\$62,298	(\$6,536)	(\$46,624)
> \$5,000,000	<u>1,019</u>	<u>\$457,314</u>	<u>\$802,520</u>	<u>\$452,218</u>	<u>(\$5,096)</u>	<u>(\$350,303)</u>
TOTAL	3,066,540	\$1,796	\$2,058	\$1,481	(\$316)	(\$577)

* Includes residential filers only. DOR model does not provide distributional impact of nonresident filers.

** Proposal: 2.5% regular rate with combined regular/Prop 208 rate capped at 4.5% on taxable income above \$250,000/\$500,000.

Table 3

Individual Income Tax Liability by Income Level under 2.55%/2.98% Rates and 4.5% Rate Cap
[Millions of Dollars]

A	B	C	D	E	F = E/C	G = E/D
Federal AGI	# Filers*	Prior to Prop 208	After Prop 208	Proposal**	% Change to Pre 208	% Change to Post 208
< \$0	39,293	\$0.8	\$0.8	\$0.7	-11.3%	-11.3%
\$0 - \$10,000	306,442	\$7.0	\$7.0	\$6.7	-3.6%	-3.6%
\$10,000 - \$20,000	409,702	\$29.7	\$29.7	\$29.0	-2.3%	-2.3%
\$20,000 - \$25,000	195,464	\$37.6	\$37.6	\$36.9	-1.8%	-1.8%
\$25,000 - \$30,000	198,412	\$55.2	\$55.2	\$54.2	-1.8%	-1.8%
\$30,000 - \$40,000	344,807	\$154.3	\$154.3	\$151.6	-1.7%	-1.7%
\$40,000 - \$50,000	261,411	\$178.6	\$178.6	\$174.2	-2.5%	-2.5%
\$50,000 - \$75,000	449,967	\$483.6	\$483.6	\$464.6	-3.9%	-3.9%
\$75,000 - \$100,000	296,485	\$521.5	\$521.5	\$487.4	-6.5%	-6.5%
\$100,000 - \$200,000	418,814	\$1,368.8	\$1,368.8	\$1,216.5	-11.1%	-11.1%
\$200,000 - \$500,000	117,693	\$1,138.6	\$1,153.9	\$896.4	-21.3%	-22.3%
\$500,000 - \$1,000,000	18,405	\$472.9	\$561.7	\$377.0	-20.3%	-32.9%
\$1,000,000 - \$5,000,000	8,626	\$593.8	\$939.6	\$553.4	-6.8%	-41.1%
> \$5,000,000	<u>1,019</u>	<u>\$466.0</u>	<u>\$817.8</u>	<u>\$462.3</u>	<u>-0.8%</u>	<u>-43.5%</u>
TOTAL	3,066,540	\$5,508.2	\$6,309.9	\$4,910.9	-10.8%	-22.2%

* Includes residential filers only. DOR model does not provide distributional impact of nonresident filers.

** Proposal: 2.55% regular rate on taxable income up to \$27,272/\$54,544; 2.98% regular rate on taxable income above \$27,272/\$54,544; and with a combined regular/Prop 208 rate capped at 4.5% on taxable income above \$250,000/\$500,000.

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Table 4

Average Individual Income Tax Liability by Income Level under 2.55%/2.98% Rates and 4.5% Rate Cap

A	B	C	D	E	F = E - C	G = E - D
<u>Federal AGI</u>	<u># Filers*</u>	<u>Prior to Prop 208</u>	<u>After Prop 208</u>	<u>Proposal**</u>	<u>\$ Change to Pre 208</u>	<u>\$ Change to Post 208</u>
< \$0	39,293	\$20	\$20	\$18	(\$2)	(\$2)
\$0 - \$10,000	306,442	\$23	\$23	\$22	(\$1)	(\$1)
\$10,000 - \$20,000	409,702	\$72	\$72	\$71	(\$2)	(\$2)
\$20,000 - \$25,000	195,464	\$192	\$192	\$189	(\$3)	(\$3)
\$25,000 - \$30,000	198,412	\$278	\$278	\$273	(\$5)	(\$5)
\$30,000 - \$40,000	344,807	\$447	\$447	\$440	(\$8)	(\$8)
\$40,000 - \$50,000	261,411	\$683	\$683	\$666	(\$17)	(\$17)
\$50,000 - \$75,000	449,967	\$1,075	\$1,075	\$1,033	(\$42)	(\$42)
\$75,000 - \$100,000	296,485	\$1,759	\$1,759	\$1,644	(\$115)	(\$115)
\$100,000 - \$200,000	418,814	\$3,268	\$3,268	\$2,905	(\$364)	(\$364)
\$200,000 - \$500,000	117,693	\$9,674	\$9,805	\$7,616	(\$2,058)	(\$2,188)
\$500,000 - \$1,000,000	18,405	\$25,694	\$30,521	\$20,486	(\$5,208)	(\$10,035)
\$1,000,000 - \$5,000,000	8,626	\$68,834	\$108,923	\$64,160	(\$4,674)	(\$44,762)
> \$5,000,000	<u>1,019</u>	<u>\$457,314</u>	<u>\$802,520</u>	<u>\$453,669</u>	<u>(\$3,645)</u>	<u>(\$348,851)</u>
TOTAL	3,066,540	\$1,796	\$2,058	\$1,601	(\$195)	(\$456)

* Includes residential filers only. DOR model does not provide distributional impact of nonresident filers.

** Proposal: 2.55% regular rate on taxable income up to \$27,272/\$54,544; 2.98% regular rate on taxable income above \$27,272/\$54,544; and with a combined regular/Prop 208 rate capped at 4.5% on taxable income above \$250,000/\$500,000.

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