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# **Federal Tax Code Conformity**

**January 2019 Update**

**January 9, 2019**

**JLBC**

# The Conformity Issue

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- ❑ Starting 1/1/18, federal government cut income taxes by \$1.5 Trillion over 10 years
- ❑ Feds reduced both individual and corporate income tax rates
- ❑ Offset some of loss with broader base (for example, eliminate/cap deductions)
- ❑ AZ uses income on the federal form as the starting point for our own individual and corporate income tax

# How Will Federal Tax Law Changes Affect AZ?

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- ❑ When feds change their income definition, AZ has to decide whether to conform in statute
- ❑ Conformity is not automatic – state needs to enact legislation. No legislation enacted yet for TY '18
- ❑ Conformity affects Tax Year 2018 forms
  - DOR makes forms available in January 2019
  - DOR preparing forms assuming conformity

# When Are AZ and Federal Taxes Linked?

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	<u>Linked</u>
<input type="checkbox"/> Tax Rates	No
<ul style="list-style-type: none"><li>• Feds lowered both individual and corporate rates, but no AZ impact</li></ul>	
<input type="checkbox"/> Deductions	Yes/No
<ul style="list-style-type: none"><li>• We do not conform to feds' standard &amp; medical deductions</li><li>• AZ currently conforms to most others</li><li>• Feds have now reduced deductions, which would generate more state revenue</li></ul>	

# Conformity Is Very Difficult to Estimate

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- ❑ Federal legislation includes over 100 provisions, is very complex and is the largest revision in the tax code in 30 years
- ❑ Some provisions can be estimated using AZ-specific data
- ❑ Most provisions, however, require prorating national data
  - Some national estimates are highly speculative
  - AZ's percent share of national estimates further adds to the speculation

# How Will Federal Tax Law Changes Affect AZ?

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□ If state conforms, FY 2019 impact would be:

	<u>\$ in M</u>
■ JLBC	133
■ DOR (January '18)	236
	(50 – 250)
■ DOR (December '18)	180 - 200

□ Impact increases by ~\$50 M in '20 under both JLBC and DOR projections

# Key Conformity Assumptions

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- ❑ Continue any current “delinking”
  - Medical expenses
  - Limit bonus depreciation to individual filers. Expanding to corporate filers costs \$68 M
  - No taxation of foreign profits
  
- ❑ JLBC Staff: Discount estimates for safety factor
  - 25% on any prorated federal estimates
  - 10% on DOR model runs (itemized deduction calculations)

# Main Conformity Provisions – JLBC Scoring

- Assumes Current Delinking Continues

	<u>\$ in M</u>
<input type="checkbox"/> Cap State & Local Taxes at \$10 K	54
<input type="checkbox"/> Cap Mortgage Interest & limit Home Equity	45
<input type="checkbox"/> Eliminate 2% Business/Employee Expenses	58
<input type="checkbox"/> Repeal Overall Cap on Itemized Deductions	(19)
<input type="checkbox"/> Limit Pass-Through Losses to \$250k/\$500k	32
<input type="checkbox"/> Higher Bonus Depreciation/Business Expensing	(47)
<input type="checkbox"/> Expand Simplified Cash Accounting	(24)
<input type="checkbox"/> Limit Interest Expense Deduction to 30% of Earnings	17
<input type="checkbox"/> Net of All Other	<u>17</u>
<b>Total</b>	<b>133</b>



# Individual vs. Business Impact, JLBC Scoring

- Assumes Current Delinking Continues

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	<u>\$ in M</u>	
	<u>'19</u>	<u>'20</u>
Individuals	174	183
Businesses	<u>(41)</u>	<u>1</u>
<b>Total</b>	<b>133</b>	<b>184</b>