State Revenue Estimates of Federal Tax Legislation Conformity

The Tax Cuts and Jobs Act (TCJA) enacted on December 22, 2017 includes over 100 provisions and represents the largest revision to the Internal Revenue Code (IRC) in more than 30 years. Many provisions became effective January 1, 2018 and sunset January 1, 2026. In part, the state tax code is tied to the federal tax code. For example, Arizona uses the federal definition of income for calculating state individual and corporate income taxes.

On January 22, 2018, the JLBC Staff published its initial estimate of the impact on state revenues if Arizona conformed to the federal tax changes. At the time, we estimated that the state would generate $133.5 million in FY 2019 General Fund revenue by conforming. We have now revised this estimate up to $154.8 million. This revision was driven by updates to the Department of Revenue tax simulation model, which our office utilizes to produce estimates for certain conformity provisions. These DOR model updates are described in more detail in the *Estimated Impact* section below.

We had previously estimated that the impact of conforming would increase to a $184.0 million General Fund revenue gain in FY 2020. Due to the revisions to the DOR model, this estimate has also increased. Our office now estimates that the FY 2020 impact would be a $217.0 million General Fund revenue gain.

These estimates remain highly speculative. In addition, the state already does not conform with several federal tax laws. Our analysis assumes that we continue to decouple from those existing provisions.

Federal Tax Legislation
- Federal estimates suggest the law will reduce federal tax revenues by $(1.5) trillion over a decade. This overall reduction is primarily achieved by lowering federal individual and corporate income tax rates. A portion of the revenue loss from lower rates is offset by added revenue from expanding the overall base of income subject to tax.
- The state revenue impact will depend on the extent that Arizona chooses to conform to federal changes. As of publication, the state has not conformed to federal tax law changes for tax year 2018.

Conformity
- For purposes of calculating state individual and corporate income taxes, Arizona must annually decide whether to conform with any changes in the federal tax code during the prior year. With some exceptions, Arizona currently conforms to the federal IRC in effect January 1, 2017.
- Arizona tax statutes use IRC definitions of federal adjusted gross income and federal taxable income as the starting point for calculating individual and corporate income tax liability, respectively. The state additionally conforms to most IRC definitions of Individual Income Tax itemized deductions. Conforming to the recently expanded federal income tax base would similarly increase the state's income tax base and revenues.
- Arizona tax rates are set in statute and do not equal federal tax rates. As a result, reductions to federal income tax rates will not result in a state conformity impact.

- To conform, the state would need to enact new legislation by referencing the IRC in effect after the passage of federal tax changes.
  - The Arizona Legislative Council has issued guidance that indicates conformity legislation that increases state revenues is not subject to the two-thirds voting requirement under Proposition 108. The policy decisions resulting in revenue increases are argued to be made at the federal level while conformity represents the state's passive adoption of those policies. If the state increases its revenues by "decoupling", however, those provisions would be subject to Proposition 108.
- During the 2018 legislative session, the Legislature enacted Laws 2018, Chapter 142, which conforms the state to any changes to federal tax law under TCJA and other federal legislation that were retroactively effective for tax year 2017.
  - In the past several years, the state conformed to the federal bonus depreciation deduction for individual income tax, but not corporate income taxpayers. TCJA included a provision that further increased the federal bonus depreciation allowance from 50% to 100% of a qualified business investment made after September 27, 2017 for both individual and corporate income tax filers. Laws 2018, Chapter 142 conforms the state to the enhanced 100% allowance for individual income taxpayers for the last 3 months of 2017. The JLBC Staff estimates that this will result in a revenue reduction of $(5.0) million in FY 2019.
- However, Chapter 142 did not conform the state to changes effective in tax year 2018, which includes most provisions from the federal legislation. As of Tax Year 2018, Chapter 142 resets the state tax laws to conform to the IRC code of January 1, 2017.
- Further legislation would need to be enacted to conform to the federal tax code for tax year 2018.

Estimated Impact

- Conforming to the TCJA is estimated to result in a $154.8 million net increase to state General Fund revenues in FY 2019. Previously, our estimate had been $133.5 million. This change is due to updates of DOR's tax simulation model. This model uses Arizona tax returns to simulate the impact of tax law changes. The results from this model are then adjusted by DOR for tax liability growth to represent the current tax year. The JLBC Staff utilized these estimates where available and reduced the DOR model estimates by 10% to reflect uncertainty.
- Previously, DOR's model was based on tax returns from tax year 2014. In January 2019, it was updated with tax returns for 2015. Because we rely on the DOR model to estimate the impact of certain provisions, this model updates caused our estimate to increase by $21.3 million.
- *Attachment 1* of this report displays estimates by conformity provision. The official federal scoring of the bill separates the provisions affecting individuals versus businesses. Our analysis provides the same delineation for consistency. The individual/business split does not equate exactly to individual and corporate income taxes. Some businesses are "pass-through" entities in which business income is "passed through" and reported as taxable income on the individual income tax form.
  - The net impact to the state includes $195.2 million in revenue increases for individuals. Of that estimate, $159.7 million is derived from the DOR tax simulation model described above. The individual income tax provisions with conformity impacts are listed below; unless otherwise noted, each projection was based on the DOR model.
    - An estimated $57.3 million would result from the $10,000 cap on state and local tax deductions.
    - An estimated $68.3 million would result from the repeal of a deduction for qualifying miscellaneous business and employee expenses above 2% of income. Most of these deductions are for unreimbursed employee business expenses, expenses incurred in income generating activities, and for tax preparation services.
    - An estimated revenue loss of $(10.5) million would result from the repeal on the limitation of itemized deductions.

        - An estimated $44.2 million would result from changes to the mortgage and home equity loan interest deductions. TCJA lowers the amount of mortgage debt for which interest payments can be deducted, from $1 million to $750,000, for mortgages taken after 2017. The law also repeals the deduction for interest paid on home equity loans. The Internal Revenue Service (IRS) has recently clarified that interest paid on home equity loans is still deductible if the loan proceeds are used to pay for repairs or renovations to the taxpayer's home.
            - The $44.2 million estimate was based on a DOR projection. However, DOR's estimate occurred before the IRS clarification that home equity loans used for home improvements or repairs still qualify for the deduction, and therefore the projection did not take this guidance into account.
            - Based on consumer surveys, roughly 50% of home equity loans may be spent for home improvement purposes. Therefore, the amount of revenue generated by conforming to these provisions would likely be closer to $22.1 million. The JLBC Staff has not formally adjusted its estimate, however, since our projections have already been adjusted for general uncertainty of the overall estimate (see below).
        - An estimated $31.6 million would be generated by limiting the deduction of pass-through losses for individual income taxpayers that own businesses. This projection was made by prorating the Joint Committee on Taxation's (JCT) national estimate of the impact of this provision.
        - The remaining $5.0 million in estimated additional General Fund revenue would result from a variety of other provisions. This projection was derived from prorated JCT estimates as well as from the FY 2013/2014 DOR Tax Expenditure Report
    - Revenue increases above are partly offset by $(40.4) million in revenue reductions to conform to business provisions, which affects both Corporate Income Tax and Individual Income Tax paid by owners of pass-through business entities. This amount was calculated based off prorated national JCT estimates.
- The JLBC Staff estimates that the impact of conforming will grow to a $217.0 million General Fund revenue gain in FY 2020. This increase is primarily driven by the business-related provisions. For example, several provisions allow businesses to depreciate equipment more quickly and shift other expenses to tax year 2018. To the extent that businesses shift expenses up to tax year 2018, they would no longer be able to deduct those specific expenses in tax year 2019, thereby increasing state revenues in FY 2020.

Decoupled Provisions

- Arizona tax statutes were previously decoupled from several IRC provisions relating to bonus depreciation, medical expense deductions and taxable foreign income. The federal tax legislation makes changes to these provisions. The JLBC Staff analysis assumes the state will continue to decouple from these items:
    - Bonus Depreciation: As noted above, federal changes increase the business allowance for first-year depreciation, from 50% to 100% of an investment. Arizona conforms to bonus depreciation for pass-through business entities, but not corporations. The JLBC estimate assumes that practice continues. Permitting corporations 100% first-year depreciation would cost $68.4 million. This change would reduce the overall conformity impact from $154.8 million to $86.4 million.
    - Medical Expenses: Under the federal legislation, the federal deduction for medical expenses is temporarily set to include spending above 7.5% of income (it had been 10% for taxpayers under 65 years of age and 7.5% for those 65 years and older). Arizona tax code currently permits a deduction of all unreimbursed medical expenses.

- Foreign Income: The federal legislation makes numerous changes to taxation of foreign income of U.S. businesses. Among other provisions, these changes include a tax on foreign income held abroad between 1986 and 2017 and an exclusion for most foreign income earned after 2017. Arizona tax code decouples from the IRC in providing a state subtraction of most foreign-derived income that is taxed at the federal level.

DOR Estimates

- In January 2018, the Department of Revenue (DOR) projected that conformity to federal changes would increase state General Fund revenues by a range of $50 million to $250 million in FY 2019. Within this range, the agency's point estimate is a $236.2 million revenue increase in FY 2019.
- In December 2018, the Executive provided an updated estimate that conformity would generate between $180.0 million and $200.0 million in FY 2019.
  - According to DOR, the lower end of this range is limited to the impact of provisions that can be estimated by DOR's tax simulation model. This estimate excludes the impact of 42 provisions which cannot be modeled *(see Attachment 1).*
  - In its January 2018 Conformity Report, DOR used Arizona's pro-rated share of nationwide federal Joint Committee on Taxation estimates for these remaining provisions, which they calculated would generate $56 million in additional revenue after technical adjustments.
  - According to DOR, the $200.0 million estimate reflects an approximate midpoint between the $180.0 million estimate and their original $236.2 million calculation.
  - From a JLBC Staff perspective, these revised DOR estimates cannot be broken down into the individual provisions of the federal legislation. As a result, we believe that their new $180.0 million to $200.0 million estimate should be viewed simply as a compromise between the JLBC Staff estimate and their own earlier $236.2 million calculation.
- In January 2019, DOR updated its tax simulation model, as discussed previously in this report. The updated model projected that conformity would raise an additional $23.7 million above what had previously been modeled by DOR in FY 2019.
- DOR has not formally adjusted its prior estimates to incorporate this updated model estimate. The JLBC Staff, however, believes that this update would increase DOR's overall conformity estimate (including non-modeled provisions) from $236.2 million to $259.9 million. This estimate is $105.1 million more than estimated by the JLBC Staff. The differences are summarized by major provision in *Attachment 2.*
- The General Fund impact of conforming to the federal tax law changes may increase in future years after FY 2019. Based on DOR's latest model run, the provisions that can be modeled would generate $215.8 million in FY 2020. DOR had previously estimated that the non-modeled provisions would produce a revenue gain of $105.5 million in FY 2020. In total, conformity would result in a FY 2020 General Fund revenue gain of $321.3 million under DOR's projections. The $321.3 million estimate has not been officially stated by DOR, and instead reflects a JLBC Staff calculation based on DOR's recent model run updates.

Uncertainty

- The official federal estimates of the federal legislation were prepared by the Congressional Joint Committee on Taxation (JCT). The JCT analysis, however, does not provide background as to the derivation of its number. To develop an Arizona score for many provisions, we

prorated the nationwide estimate. In general, Arizona's projected share of a federal impact reflects the state's taxable income and tax rates, as ratios of nationwide federal taxable income and tax rates. There are limitations to this method, including:
    - The size and complexity of recent federal tax code changes likely makes nationwide JCT estimates for many provisions speculative.
    - The proration method is a highly simplified method and may not accurately reflect the actual Arizona net impact. As a result, we increased negative revenue impacts by 25% and decreased positive revenue impacts by (25)% to produce a more cautious estimate.
- The JLBC Staff used results from DOR's individual income tax simulation model as a base for estimating changes to itemized deductions. DOR's model originally used a sample of taxpayer data from tax year (TY) 2014, which the agency then grew to approximate the base of taxpayers in TY 2018. In January 2019, DOR updated their model for TY 2015 data and once again projected that information to TY 2018. The JLBC Staff estimates include the following adjustments:
    - Model estimates were reduced (10)% to account for uncertainty in scaling TY 2015 taxpayer data to TY 2018. A discount factor of less than 25% was chosen to reflect that DOR model estimates more accurately reflect Arizona impacts than JCT prorated amounts.
    - DOR model estimates were reduced $(17.0) million to incorporate a provision that could not be accounted for in the agency's model. The federal legislation places a $10,000 cap on deductions of state and local taxes paid by individuals, but excludes taxes of pass-through businesses from the cap. The JLBC Staff reduced DOR's estimates $(17.0) million to incorporate the business tax exclusion.
- Given the fact that conforming to federal tax law changes has been Arizona's standard practice in the past, some taxpayers may have preemptively adjusted their estimated payments assuming that the state would conform. If that behavior were occurring, some revenues associated with conformity would already be included in individual income tax payments received so far in FY 2019. Through December, FY 2019 individual income tax revenues have increased by 0.6%. While this does not point to taxpayers adjusting their estimated payments to account for conformity, the JLBC Staff lacks information to rule out this possibility.
- Some conformity provisions that are listed in *Attachment 1* of this report are not listed in DOR's conformity report. The JLBC Staff has reached out to DOR to confirm whether all provisions in *Attachment 1* represent conformity issues. At the time of publication, however, DOR has not responded.

#	Provision	Changes to Federal Law	Tax	Effective	General Fund Impact ($ in Millions) FY 2019 1/	FY 2020 1/	Source
INDIVIDUAL PROVISIONS							
1	Repeal deduction for miscellaneous expenses above 2% of income	• Repeals an itemized deduction permitted for miscellaneous expenses exceeding 2% of federal adjusted gross income. • Qualifying deductible expenses generally include unreimbursed employee spending, tax preparation services, and expenses of certain income-generating activities.	IIT	Tax Year (TY) 2018 to TY 2025	$ 68.3	$ 75.4	DOR Conformity Report; JLBC Modified 2/
2	Cap deduction for state and local taxes paid at $10,000	• Taxpayers may take an itemized deduction of state and local income and property taxes paid or state and local sales and property taxes paid. • Caps the deduction of state and local taxes paid at $10,000. • The cap does not apply to taxes paid in association with activities of pass-through entities. Department of Revenue (DOR) conformity estimates do not account for the pass-through entity exclusion. JLBC Staff has reduced DOR's estimate by $(17.0) million to incorporate the exclusion.	IIT	TY 2018 to TY 2025	$ 57.3	$ 66.6	DOR Conformity Report; JLBC Modified 2/
3	Conform to medical expense deduction 3/	• Previously, the federal deduction for out-of-pocket medical expenses equaled expenses above 10% of federal adjusted gross income. Qualifying deductible expenses include most out-of-pocket physical care, behavioral health, dental, and vision expenses. (Arizona allows a deduction for all medical expenses) • Federal changes temporarily increase the federal deduction to expenses above 7.5% of FAGI in TY 2017 and TY 2018. • State revenue estimates assume Arizona continues to permit a full medical expense deduction. If the state were to conform to the reduced federal deduction, state revenues would increase by an estimated $59.1 million in FY 2019 and $65.0 in FY 2020	IIT	TY 2017 and TY 2018	$ -	$ -	
4	Repeal limitation on allowable itemized deductions	• Previously, total itemized deductions were reduced by 3% of income above thresholds ($261,500 for single filers and above $313,800 for joint filers in TY 2017). The maximum reduction was limited to 80% of itemized deductions. • Removes the limit on total itemized deductions.	IIT	TY 2018 to TY 2025	$ (10.5)	$ (12.1)	DOR Conformity Report; JLBC Modified 2/
5	Repeal deduction for home equity loan interest and limit deduction of mortgage interest	• Lowers the amount of mortgage debt for which interest payments can be deducted, from $1 million to $750,000, for mortgages taken after 2017. • Repeals the deduction of interest paid on up to $100,000 of certain home equity loan debt, regardless of the date the loan was taken. The repeal of this deduction only applies to home equity loans for which the proceeds were used for purposes other than to renovate or repair the taxpayers home. • The stated estimate that this provision would raise $45.0 million is likely overstated. This estimate was based on the DOR Conformity Report. DOR did not take into account that in many cases, the interest on home equity loans is still deductable. • Based on survey estimates, approximately 50% of taxpayers use home equity loans for home improvement projects. Based on IRS guidance, the interest payments on these loans are still deductable. Therefore, the JLBC Staff believes that the actual revenue generated from this TCJA provision would be closer to $22.5 million. • Since the overall JLBC Staff estimate has already been reduced for general uncertainity, the $45.0 million revenue projection has not been further adjusted downwards.	IIT	TY 2018 to TY 2025	$ 44.2	$ 48.6	DOR Conformity Report; JLBC Modified 2/

#	Provision	Changes to Federal Law	Tax	Effective	General Fund Impact ($ in Millions) FY 2019 1/	FY 2020 1/	Source
INDIVIDUAL PROVISIONS CONTINUED							
6	Repeal deduction for non-disaster property casualty losses	• Repeals the current deduction of non-disaster property losses arising from fire, storm, theft, shipwreck or other casualty.	IIT	TY 2018 to TY 2025	$ 0.4	$ 0.5	DOR Conformity Report; JLBC Modified 2/
7	Permit property casualty loss deduction for disaster areas	• Permits a deduction for unreimbursed property casualty losses inccured during a disaster, as declared by the U.S. President.	IIT	TY 2018 and after			
8	Increase deduction limit for charitable contributions	• Raises the limit on deduction for cash contributions to public charities and certain private foundations from 50% to 60% of federal adjusted gross income.	IIT	TY 2018 to TY 2025	Unkown -	Unkown -	
9	Repeal charitable contribution deduction for athletic event seating	• Repeals a deduction permitted for donations made to an educational institution secure the right to purchase athletic event tickets.	IIT	TY 2018 and after	Unknown +	Unknown +	
10	Limit deduction for wagering losses	• Limits deduction for gambling losses and expenses incurred in wagering transactions to the individual's amount of wagering winnings. Currently, the limit only applies to deductions for gambling losses.	IIT	TY 2018 to TY 2025	Unknown +	Unknown +	
11	Deny deduction of costs associated with violating a law	• Taxpayers may not deduct fines or penalties paid to a government for violation of any law.	IIT	December 22, 2017	Unknown +	Unknown +	
12	Limit pass through of a business loss to offset other individual income	• Owners that actively participate in business operations can use business losses of a pass-through entity to reduce other sources of taxable individual income. • Limits the deduction for pass-through losses to $250,000 (single filers) / $500,000 (joint filers). • Losses above $250,000/$500,000 may be carried forward as a net operating loss for use in calculating business income in later years.	IIT	TY 2018 to TY 2025	$ 31.6	$ 33.6	JCT pro-rated 4/
13	Repeal subtraction of unreimbursed moving expenses	• Repeals the subtraction from income of unreimbursed moving expenses incurred as a result of starting a new job. • The exclusion is retained for active duty military. (The exclusion is not incorporated into state estimates.)	IIT	TY 2018 to TY 2025	$ 1.7	$ 1.7	DOR FY 13/FY14 Tax Expenditure Report; JLBC grew impact to FY 19 5/
14	Repeal exclusion of employer-reimbursed moving expenses	• Repeals exclusion from income of employer reimbursement of moving expenses. • Exclusion is retained for active duty military.	IIT	TY 2018 to TY 2025	$ 1.2	$ 1.2	JCT pro-rated 4/
15	Require a 3-year holding period of carried interest to qualify as long-term capital gains income.	• Previously, annual profit distributions to partners of investment funds (carried interest) could qualify for reduced federal tax rates as long-term capital gains income (held 12 months or more). (Arizona currently provides a 25% subtraction for long-term capital gains on assets purchased after 2011) • Imposes a 3-year holding period of such distributions in order to qualify as long-term capital gains at reduced federal tax rates.	IIT	TY 2018 and after	$ 0.4	$ 0.4	JCT pro-rated 4/
16	Repeal tax deferral for capital gains invested in qualifying small businesses	• Previously, capital gains income on the sale of public securities could be deferred up to certain limits, if the gain was used to invest in a Specialized Small Business Investment Corporation (SSBIC). These federally-designated private companies provide equity and debt financing to small businesses. • Repeals the deferral of capital gains income for sales of securities after 2017.	IIT/CIT	TY 2018 and after	$ 0.4	$ 0.4	JCT pro-rated 4/

#	Provision	Changes to Federal Law	Tax	Effective	General Fund Impact ($ in Millions) FY 2019 1/	FY 2020 1/	Source
INDIVIDUAL PROVISIONS CONTINUED							
17	Repeal subtraction of alimony payments made and provide exclusion of payments received from income	• Repeals subtraction of alimony payments associated with divorces after 2018. • Permits alimony payments received to be excluded from federal adjusted gross income for individuals divorced after 2018.	IIT	TY 2019 and after	$ 0.2	$ 0.2	JCT pro-rated 4/
18	Repeal exclusion of income from Advance Refunding Bonds	• Repeals the exclusion of interest income earned on municipal bonds used to refund another bond over a period longer than 90 days. Effective for bonds issued after 2017. (Arizona only exempts income earned on Arizona municipal bonds.)	IIT/CIT	TY 2018 and after	Unknown +	Unknown +	
19	Repeal rule to recharacterize contributions and conversions between Traditional and Roth IRAs	• Taxpayers that convert their Traditional individual retirement account (IRA) to a Roth IRA, and vice versa, are no longer permitted to reverse the conversion.	IIT	TY 2018 and after	Minimal +	Minimal +	JCT pro-rated 4/
20	Repeal exclusion of employer-paid fringe benefits for bicycle commuters	• Repeals an exclusion of up to $20 a month in payments from employers as reimbursement for bicycle commuting expenses.	IIT	TY 2018 to TY 2025	Minimal +	Minimal +	JCT pro-rated 4/
21	Permit use of 529 savings accounts for primary and secondary education	• 529 accounts provide tax-advantaged savings for college expenses. (Arizona also permits a subtraction of contributions to 529 accounts, up to $2,000 for single filers and $4,000 for joint filers.) • Permits up to $10,000 in 529 accounts to be used annually for elementary or secondary education costs each year.	IIT	TY 2018 and after	Minimal -	Minimal -	JCT pro-rated 4/
22	Permit rollovers from 529 savings accounts to ABLE accounts	• Permits tax-free rollover of 529 plan balances to Achieving a Better Life Experience accounts to fund expenses for disabled individuals.	IIT	TY 2018 to TY 2025	Minimal -	Minimal -	JCT pro-rated 4/
23	Increase ABLE account contribution limit for amounts contributed by beneficiaries	• Donors can contribute up to $14,000 annually to Achieving a Better Life Experience accounts for funding qualified expenses of disabled beneficiaries. • Permits an additional contribution by account beneficiaries, above the $14,000 contributed by benefactors, equal to the lesser of the federal poverty level for an individual or the contributor's earnings for the year.	IIT	TY 2018 to TY 2025	Minimal -	Minimal -	JCT pro-rated 4/
24	Exclude forgiven student loan debt discharged due to death or disability	• Provides a new exclusion of debt discharged as a result of death or total disability of the borrower. Effective for debt discharged after 2017.	IIT	TY 2018 to TY 2025	Minimal -	Minimal -	JCT pro-rated 4/
25	Extend combat zone tax benefits to individuals working in Sinai Peninsula of Egypt	• Members of the armed forces serving in a designated combat zone are provided several tax benefits. • Extends the same tax benefits to individuals working in the Sinai Peninsula of Egypt.	IIT	June 9, 2015 to TY 2025	Minimal -	Minimal -	JCT pro-rated 4/
	SUBTOTAL: INDIVIDUAL PROVISIONS				**$ 195.2**	**$ 216.3**	3/

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BUSINESS PROVISIONS							
26	Increase business expensing allowance	• Previously, small businesses could expense up to $500,000 of equipment in the year of investment, in addition to any amount under regular depreciation schedules. The allowance began to phase out for large companies investing over $2 million a year. For example, a company investing $2.1 million could expense $400,000 in the year of investment ($500,000 cap - ($2.1 million invested - $2.0 million phase-out threshold). (Arizona conforms to federal allowance for both pass-through entities and corporations.) • Increases the business expensing allowance to $1 million, raises the phase-out threshold to $2.5 million, and indexes those amounts to inflation. TCJA also expands the definition of qualifying property to property used to furnish lodging and certain improvements to non-residential real property. • Preliminary estimates suggest the provision could reduce state revenues by $(24.1) million in FY 2019. The validity of that amount is highly uncertain, due to technical issues of converting from the federal estimates.	IIT/CIT	TY 2018 and after	$ (24.1)	(13.3)	JCT pro-rated 4/
27	Increase bonus depreciation allowance	• Previously, businesses could depreciate 50% of new equipment in the year of investment, in addition to any amount under regular depreciation schedules. The allowance would have phased down to 0% by TY 2020. (Arizona conforms to the federal allowance for pass-through entitites, but not corporations.) • Under TCJA, the federal allowance is increased to 100% through TY 2022, then gradually phases down to 0% in TY 2027. • Expands the allowance to used equipment, as well as equipment for film, television, and theatrical productions. (State revenue estimate does not incorporate this provision). • Preliminary estimates suggest the provision could reduce state revenues by $(18.0) million in FY 2019. This estimate assumes the state raises its bonus depreciation allowance from 50% to 100% for pass-through entities, but continues to exclude C corporations from the allowance. If the state also extends the 100% allowance to C corporations, the state revenue reduction would increase $(68.4) million, to $(90.9) million. • The validity of these estimates is highly uncertain, due to technical issues of converting from the federal estimates.	IIT	For investments after 9/27/2017	$ (22.5)	(15.2)	JCT pro-rated 6/7/
28	Expand eligibility of small businesses to use simplified cash accounting	• Expands gross receipts thresholds for determining which businesses may use simplified cash methods of accounting from $5 million to $25 million.	IIT/CIT	TY 2018 and after	$ (24.4)	(10.7)	JCT pro-rated 4/

#	Provision	Changes to Federal Law	Tax	Effective	General Fund Impact ($ in Millions) FY 2019 1/	FY 2020 1/	Source
BUSINESS PROVISIONS CONTINUED							
29	Limit interest expense deduction	• Previously, businesses could take a deduction for the full amount of interest paid on debt. • In TY 2018 to TY 2021, limits the deduction to 30% of earnings, before interest, tax, and depreciation. The 30% limit is calculated off earnings before interest and taxes in later years. • Permits interest above the 30% limit to be carried forward and deducted in any future year. • The 30% limit would not apply to a business with less than $25 million in average gross receipts during the 3 prior taxable years.	CIT/IIT	TY 2018 and after	$ 16.5	$ 18.4	JCT pro-rated 7/
30	Repeal deduction for domestic production activities	• Repeals current deduction of up to 9% of income (6% for oil and gas activities) earned on qualified U.S. production activities, such as manufacturing, extraction, construction, and farming.	CIT/IIT	TY 2018 and after	$ 8.3	$ 8.7	JCT pro-rated 7/
31	Deferral or elimination of taxes owed on capital gains reinvested in Opportunity Zones	• Establishes rules for designation of certain low-income locations as Opportunity Zones. Private investments may be made by Opportunity Funds in Opportunity Zone property. • A taxpayer may defer tax owed on capital gains income that is reinvested in an Opportunity Fund. • Taxpayers do not have to pay taxes on the gains associated with investment in the Opportunity Fund.	IIT/CIT	December 22, 2017 to December 31, 2026	$ (5.5)	$ (5.2)	JCT pro-rated 4/
32	Limit net operating loss deduction	• Previously, businesses may carryforward operating losses up to 20 years and carry back losses 2 years for purposes of reducing taxable income. Losses may reduce taxable income by up to 100%. (Arizona conforms for pass-through entities, with the exception that it has not permitted a 2 year carryback. The state provides a separate calculation net operating loss deductions for corporations than used at the federal level). • Under TCJA: ○ Losses incurred after 2017 may not reduce taxable income by more than 80%. ○ Carrybacks are eliminated for losses incurred after 2017. ○ Losses may be carried forward indefinitely. • State revenue estimates reflect net operating loss conformity for individual taxpayers. Estimates assume 20% of the nationwide estimate represents the impact specific to individual income taxpayers.	IIT	TY 2018 and after	$ 3.9	$ 4.3	JCT pro-rated 4/ and JLBC modified
33	Repeal and modify deductions for expenses of certain fringe benefits	• Repeals current 50% deduction for expenses of entertainment, recreation, and organizational memberbership dues. • Limits deduction for food expense provided at employer-operated facilities to 50% • Repeals current deduction of certain transportation fringe benefits, such as costs of qualified parking and mass transit passes.	CIT/IIT	TY 2018 and after for most provisions	$ 3.5	$ 4.8	JCT pro-rated 7/
34	Modify accounting rules for timing of income	• Specifies that income must be recognized for accounting and tax purposes no later than the taxable year it is counted in audited financial statements.	CIT/IIT	TY 2018 and after	$ 1.9	$ 3.1	JCT pro-rated 7/
35	Modify treatment of S corporation conversions to C corporations	• Makes several adjustments concerning treatment of distributions following conversion of an S corporations to a C corporation.	IIT	TY 2018 and after	$ (1.6)	$ (1.6)	JCT pro-rated 4/

#	Provision	Changes to Federal Law	Tax	Effective	General Fund Impact ($ in Millions) FY 2019 1/	FY 2020 1/	Source
BUSINESS PROVISIONS CONTINUED							
36	Phase out deductions of Federal Deposit Insurance Corporation premiums	• Gradually phases out the deduction of premiums paid to the Federal Deposit Insurance Corporation for banks with at least $10 billion in assets. The deduction is eliminated for banks with assets greater than $40 billion.	CIT/IIT	TY 2018 and after	$ 1.4	$ 4.2	JCT pro-rated 7/
37	Repeal exceptions to $1 million compensation deduction limit	• Businesses may deduct up to $1 million of an employee's compensation as a business expense. Previously, the $1 million cap did not apply to stock options, commissions, payments to retirement plans, and other items. -Eliminates the exceptions to the $1 million cap listed above, reducing the amount of compensation a business can deduct.	CIT/IIT	TY 2018 and after	$ 0.9	$ 0.9	JCT pro-rated 7/
38	Limit deferral of income on like-kind exchange of property	• Capital gains from exchange between 2 companies earned on property held for productive use in a business is deferred until property is resold. • Limts deferral of tax to exchanges of real property.	CIT/IIT	TY 2018 and after	$ 0.8	$ 1.5	JCT pro-rated 7/
39	Repeal technical termination of partnerships	• Repeals a rule that automatically terminates and reforms a partnership when 50% or more of ownership is sold.	IIT	TY 2018 and after	$ 0.4	$ 0.6	JCT pro-rated 4/
40	Treatment of qualified equity grants	• Permits certain employees to defer income associated with stock transferred from the employer until the stock is considered tradable. Employers may not deduct any withholding associated with the deferred income until the employee is taxed on the amount.	IIT/CIT	TY 2018 and after	$ (0.3)	$ (0.3)	JCT pro-rated 7/
41	Require separate calculations of unrelated business income tax	• Gross income that is unrelated to the primary purposes of tax-exempt organizations under 501(a) is subject to the unrelated business income tax. Such income is taxed at the highest corporate tax rate. • Requires that unrelated business income tax is calculated separately for each unrelated business in order to prevent losses being used to offset income in another unrelated business.	UBIT/CIT	TY 2018 and after	$ 0.3	$ 0.3	JCT pro-rated 7/
42	Revision to exclusion of contributions to capital	• Repeals exclusion of contributions to capital by a government or civic group that is not in exchange for stock in the corporation.	CIT/IIT	TY 2018 and after	$ 0.2	$ 0.4	JCT pro-rated 7/
43	Modify definitions of certain property for depreciation purposes	• Qualified restaurant and retail improvement property are now considered qualified improvement property subject to a 15-year recovery period.	CIT/IIT	TY 2018 and after	$ (0.2)	$ (0.2)	JCT pro-rated 7/
44	Repeal deduction of local lobbying expenses	• Repeals current deduction for lobbying expenses in connection with local government legislation.	CIT/IIT	December 22, 2017	$ 0.1	$ 0.1	JCT pro-rated 7/
45	Modifications that effectively expand interest deduction for craft beverage makers	• Previously, interest paid by craft beverage producers could not be deducted during the production/aging period and must instead be incorporated into the value of inventory or other property. TCJA permits the interest expenses to be deducted during the production period.	CIT/IIT	TY 2018 and TY 2019	Unknown -	Unknown -	
46	Eliminate deduction for living expenses of members of Congress	• Eliminates the $3,000 a year deduction of living expenses incurred by members of Congress while traveling outside their district.	IIT	TY 2018 and after	Minimal +	Minimal +	JCT pro-rated 4/

#	Provision	Changes to Federal Law	Tax	Effective	General Fund Impact ($ in Millions) FY 2019 1/	FY 2020 1/	Source
BUSINESS PROVISIONS CONTINUED							
47	Deny deduction of settlement payments for sexual harassment	• Prevents businesses from deducting expenses associated with settlement of sexual harassment or abuse allegations, when the settlement is subject to a non-disclosure agreement.	CIT/IIT	Date of enactment	Minimal +	Minimal +	JCT pro-rated 7/
48	Expands definition of qualifying beneficiaries of an electing small business trust	• Expands definition of beneficiaries of electing small business trusts that hold shares of S corporations to include non-citizens.	IIT	TY 2018 and after	Minimal -	Minimal -	JCT pro-rated 4/
49	Shorten depreciation schedule for farm property	• Reduces the number of years that certain farm equipment may be depreciated, from 7 to 5 years.	IIT/CIT	TY 2018 and after	Minimal -	Minimal -	JCT pro-rated 4/
50	Expands deduction for replacing damaged citrus plants	• Extends a deduction for costs of replacing damaged citrus plans to passive owners with at least a 50% stake in the business or to new owners that purchase an affected farm.	IIT/CIT	TY 2018 to TY 2027	Minimal -	Minimal -	JCT pro-rated 4/
	SUBTOTAL: BUSINESS PROVISIONS				**$ (40.4)**	**$ 0.7**	6/
	TOTAL: INDIVIDUAL AND BUSINESS PROVISIONS				**$ 154.8**	**$ 217.0**	3/6/

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1/ The first full year of impact for most provisions will occur in FY 2019, though the initial impact of many provisions may begin in FY 2018. The impact of some provisions begins after FY 2019. The impact of certain provisions either increases or decreases in FY 2020 and later years.

2/ DOR estimated provisions under items 1 through 7 using an individual income tax simulation model. In total, DOR originally estimated the provisions would increase state revenues by $170.8 million in FY 2019 and $180.0 million in FY 2020. In January 2019, DOR released an updated model simulations that increased these estimates to $194.5 million and $215.8 million respectively. The agency's estimate does not incorporate an exclusion provided for business taxes in calculating allowable deductions of state and local taxes under TCJA. JLBC Staff has reduced DOR's estimates by $(17.0) million to incorporate this exclusion. To produce a more cautious estimate, the results were further reduced (10)%.

3/ Estimates assume the state continues to not conform to the federal medical deduction allowance by continuing the full state deduction of expenses. If the state were to conform to the limited federal deduction, though, state conformity revenue estimates would be increased by $59.1 million in FY 2019. This estimate is baesd on the DOR tax simulation model.

4/ Arizona pro-rated estimate is 0.26% of FFY 2019 nationwide federal revenue estimate prepared by the Congressional Joint Committee on Taxation. The state share is the ratio of state/federal individiual income tax liability (TY 2015 data). Estimates derived from this pro-ration method are speculative. To produce a more cautious estimate, negative revenue impacts were increased 25% while positive impacts were reduced 25%.

5/ DOR estimates the moving expense subtraction reduced General Fund revenues by $(1.3) million in TY 2012. The average growth in subtractions was 10.5% from TY 2007 to TY 2012. The JLBC Staff grew DOR's TY 2012 estimate to TY 2018, assuming a 10.5% annual growth rate.

6/ Estimates assume the state continues to not conform to the federal bonus depreciation allowance for C corporations. If the state were to conform for C corporations, state conformity revenue estimates would be decreased by $(68.4) million.

7/ Arizona pro-rated estimate is 0.12% of FFY 2019 nationwide federal revenue estimate prepared by the Congressional Joint Committee on Taxation. The state share is the ratio of state/federal corporate income tax liability (TY 2013 data; adjusted for subsequent Arizona corporate income tax rate reductions). Estimates derived from this pro-ration method are speculative. To produce a more cautious estimate, negative revenue impacts were increased 25% while positive impacts were reduced 25%.

DOR and JLBC Conformity Estimates by Major Provision

Federal Provision	FY 2019 General Fund Impact ($ in Millions) DOR	JLBC	DOR - JLBC
INDIVIDUAL PROVISIONS			
Modeled Provisions 1/			
Cap Deduction for State and Local Taxes Paid at $10,000	$ 80.8	57.3	$ 23.5
Repeal Deduction for Miscellaneous Deductions Above 2% of Income	75.9	68.3	$ 7.6
Modify Mortgage Interest and Home Equity Deductions	49.1	44.2	$ 4.9
Repeal Overall Cap on Itemized Deductions	(11.8)	(10.5)	$ (1.3)
Repel deduction for non-disaster property casuality losses	0.5	0.4	$ 0.1
Subtotal: Modeled Provisions	194.5	159.7	$ 34.8
JCT Proration and DOR Tax Expenditure Report 2/			
Limit pass through of a business loss to offset other individual income	52.6	31.6	21.0
Repeal subtraction of unreimbursed moving expenses	2.8	1.7	1.1
Repeal exclusion of employer-reimbursed moving expenses	2.0	1.2	0.8
Repeal subtraction of alimony payments made and provide exclusion of alimony payments received from income	0.2	0.2	0.0
Other Individual Provisions	na	0.8	(0.8)
Subtotal: JCT Proration and DOR Tax Expenditure Report	57.6	35.5	22.1
SUBTOTAL: INDIVIDUAL PROVISIONS	**$ 252.1**	**$ 195.2**	**$ 56.9**
BUSINESS PROVISIONS 2/			
Expand eligibility of small businesses to use simplified cash accounting	$ (14.6)	$ (24.4)	$ 9.8
Increase business expensing allowance	(12.1)	(24.1)	12.0
Increase bonus depreciation allowance	(27.4)	(22.5)	(4.9)
Limit interest expense deduction	30.1	16.5	13.6
Repeal deduction for domestic production activities	13.5	8.3	5.2
Limit net operating loss deduction	6.7	3.9	2.8
Repeal deductions for expenses of certain fringe benefits	6.5	3.5	3.0
Modify treatment of S corporation conversions to C corporations	(0.7)	(1.6)	0.9
Other Business Provisions	5.9	(0.0)	5.9
SUBTOTAL: BUSINESS PROVISIONS	**$ 7.8**	**$ (40.4)**	**$ 48.3**
TOTAL INDIVIDUAL AND BUSINESS PROVISIONS	**$ 259.9**	**$ 154.8**	**$ 105.1**

1/ The JLBC Staff estimate adopts the Department of Revenue (DOR) amount, but makes adjustments to incorporate a provision not estimated by the agency's tax simulation model. The modified estimate was then reduced 10% to recognize the agency's limited ability to project FY 2019 impacts using TY 2015 taxpayer data.

2/ With the exception of the provision repealing the subtractions for unreimbursed and reimbursed moving expenses, estimates were produced by prorating national Joint Committee On Taxation (JCT) estimates. Due to uncertainty about the accuracy of estimated impacts, initial calculations made by the JLBC Staff were adjusted to produce more cautious estimates. In general, negative revenue estimates were increased 25% while positive estimates were reduced 25% from initial JLBC Staff estimates.