LEGISLATIVE FISCAL OFFICE
Fiscal Note

Fiscal Note On: **HB 507** HLS 13RS 874
Bill Text Version: **ORIGINAL**
Opp. Chamb. Action:
Proposed Amd.:
Sub. Bill For.:

Date: April 13, 2013 3:37 PM **Author:** IVEY
Dept./Agy.: Revenue
Subject: Phases Out The Personal Income Tax **Analyst:** Greg Albrecht

TAX/INCOME TAX OR -$86,000,000 GF RV See Note
Provides for a 10-year phase out of the state tax levied on the net income of individuals beginning Jan. 1, 2016

Phases out the personal income tax evenly over a ten year period. Rates of tax are reduced by 10% for the taxable year beginning during 2016. Each tax thereafter an additional ten percentage point reduction is applied. No tax will be assessed for any tax year beginning during 2025.

Effective July 1, 2013, and applicable to all taxable years beginning on and after January 1, 2016.

EXPENDITURES	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**5 -YEAR TOTAL**
State Gen. Fd.	$0	$0	$0	$0	$0	**$0**
Agy. Self-Gen.	$0	$0	$0	$0	$0	**$0**
Ded./Other	$0	$0	$0	$0	$0	**$0**
Federal Funds	$0	$0	$0	$0	$0	**$0**
Local Funds	$0	$0	$0	$0	$0	**$0**
Annual Total	**$0**	**$0**	**$0**	**$0**	**$0**	**$0**

REVENUES	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**5 -YEAR TOTAL**
State Gen. Fd.	$0	$0	($86,000,000)	($478,000,000)	($881,000,000)	**($1,445,000,000)**
Agy. Self-Gen.	$0	$0	$0	$0	$0	**$0**
Ded./Other	$0	$0	$0	$0	$0	**$0**
Federal Funds	$0	$0	$0	$0	$0	**$0**
Local Funds	$0	$0	$0	$0	$0	**$0**
Annual Total	**$0**	**$0**	**($86,000,000)**	**($478,000,000)**	**($881,000,000)**	**($1,445,000,000)**

EXPENDITURE EXPLANATION

The Department of Revenue would incur costs involved in modifying all of its systems dealing with the individual income tax. Taxpayer education and compliance support expenses would also be incurred. Once the tax is fully phased out resource reallocations in the Department would seem appropriate from individual income tax to the remaining taxes collected by the Department.

REVENUE EXPLANATION

The bill provides a phase out of the personal income tax starting with the 2016 tax year. The phase out progresses over a ten year period, with rates declining from their current levels by 10% per year. No tax is levied as of tax year 2025.

The estimated annual revenue reductions are based on the current official forecasts of personal income tax and grow beyond that horizon at the average rate over that forecast period (5.38% per year). The phase out starts mid-way through FY16, and withholding tables are assumed to be adjusted for each tax year. Due to the withholdings process, a portion of each tax year's revenue reduction occurs in the last half of the fiscal year (see FY16 in table above). Based on collections data, key assumptions underlying the annual revenue loss estimates are (a) 80% of revenue is collected via withholdings (10% spring payments, 10% declarations and fiduciary), (b) 52% of gross withholdings are received in the second half of a fiscal year (32% declarations, and all spring payments) and, (c) a 3-month delay occurs for withholding changes to materially occur. These assumptions along with the phase out schedule are applied to the baseline projection of income tax collections to generate the estimated annual revenue reductions depicted in the table above. Revenue reductions for the remainder of the phase out period are: $1.306 billion in FY19, $1.756 billion in FY20, $2.234 billion in FY21, $2.745 billion in FY22, $3.291 billion in FY23, $3.876 billion in FY24, $4.504 billion in FY25, and $5.067 billion. At that point nearly all personal income tax collections should cease, although three prior tax periods will presumably still be open, with payments and refunds still possible. In addition, there are $100 million to $140 million of refunds that taxpayers carry over each year and apply to subsequent year liabilities. Early in a phase out taxpayers may not change this behavior materially. Eventually, though, these carry overs will have to be refunded to taxpayers, resulting in greater revenue losses in those periods than estimated above.

The bill phases out a major state revenue source, against which the cost of various benefits are charged. For nonrefundable tax credits (55 credits, $197 million), the phase out of the tax is likely more beneficial to recipients than the credits themselves, although there may be an issue of <u>how to resolve the benefit of unused credit amounts</u> that are carried forward from prior years. A similar issue has to do with refundable credits (27 credits, $156 million). In this case, 100% of the benefit is available immediately to recipients regardless of tax liability. <u>If this tax is phased out, it is not clear if these benefits phase out as well.</u> If these benefit are to continue after the tax is phased out, then total costs to the state from phasing out this tax will be effectively greater than depicted here. The state would lose the net revenue expected from the tax after all benefits are charged, and the state would still have the costs of the benefits to cover with other revenue collections or appropriations. A small <u>dedication to the Sports Facility Assistance Fund</u> ($3m per year) will also phase down as the tax phases out.

Senate	Dual Referral Rules	House
☐ 13.5.1 >= $100,000 Annual Fiscal Cost {S&H}		☐ 6.8(F) >= $500,000 Annual Fiscal Cost {S}
☒ 13.5.2 >= $500,000 Annual Tax or Fee Change {S&H}		☐ 6.8(G) >= $500,000 Tax or Fee Increase or a Net Fee Decrease {S}

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