LEGISLATIVE FISCAL OFFICE
Fiscal Note

Fiscal Note On: **HB 1** HLS 243ES 13

Bill Text Version: **REENGROSSED**

Opp. Chamb. Action:

Proposed Amd.:

Sub. Bill For.:

Date: November 17, 2024 10:52 AM

Author: EMERSON

Dept./Agy.: Revenue

Subject: Flat IIT Rate, Exemption, Deduction, & Trigger Changes

Analyst: Benjamin Vincent

TAX/INCOME TAX RE DECREASE GF RV See Note

Provides for a flat rate for purposes of calculating income tax for individuals, estates, and trusts, increases the standard deduction, and modifies or repeals certain income tax deductions and credits (Item #5 and 6)

Proposed law specifies a flat tax rate of 3% on all income that is subject to Individual Income Tax (IIT), and repeals certain personal exemptions and net capital gains deductions.
The bill additionally increases the $4,500 standard deductions to $12,500 and the $9,000 standard deductions to $25,000, and further adjusts both by CPI-U inflation in all subsequent years. Proposed law doubles the exemption on pension and annuity income for filers aged 65+ from $6,000 to $12,000, and further adjusts by CPI-U inflation in all subsequent years.
The bill also authorizes full expensing ("Bonus Depreciation") for certain capital investment, based on the date that the capital is placed into service, and sunsets the allowance of claiming certain credits against IIT.
Proposed law alters the existing IIT rate reduction triggers using new methods and definitions, and removes the existing 2034 sunset on trigger assessments. Applicable to taxable years beginning on or after January 1, 2025.

EXPENDITURES	2024-25	2025-26	2026-27	2027-28	2028-29	5 -YEAR TOTAL
State Gen. Fd.	$0	$0	$0	$0	$0	**$0**
Agy. Self-Gen.	**$550,000**	$0	$0	$0	$0	**$550,000**
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	**$550,000**	**$0**	**$0**	**$0**	**$0**	**$550,000**

REVENUES	2024-25	2025-26	2026-27	2027-28	2028-29	5 -YEAR TOTAL
State Gen. Fd.	**($331,000,000)**	**($1,138,000,000)**	**($1,317,000,000)**	**($1,336,000,000)**	**($1,346,000,000)**	**($5,468,000,000)**
Agy. Self-Gen.	**($3,000,000)**	**($12,000,000)**	**($13,000,000)**	**($14,000,000)**	**($14,000,000)**	**($56,000,000)**
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	**($334,000,000)**	**($1,150,000,000)**	**($1,330,000,000)**	**($1,350,000,000)**	**($1,360,000,000)**	**($5,524,000,000)**

EXPENDITURE EXPLANATION

LDR reports anticipated one-time expenditures for minor system design and specification updates, testing, and system development in support of tax return modifications and processing system modification. Anticipated costs total approximately $550,000. Any expenditure increases would be financed via SGR out of current collections, ultimately reducing SGF revenue mechanically. LFO assumes that these expenditures would impact FY 25.

REVENUE EXPLANATION

Overall fiscal impact of this proposal can be approximated by the impact of the overall change in liabilities implied by the rate, deduction, and exemption changes, modified by net collections increases due to credit repeals. LFO estimates a total FY 25 impact of -$334 million, FY 26 impact of -$1.15 billion, FY 27 impact of -$1.33 billion, and FY 28 impact of -$1.35 billion. Proposed law reduces certain collections that LDR is currently permitted to retain 1% of as SGR, reflected in the table above as reduced Self-generated revenues.

Effects on FY 25 are due to the effective date of the bill and primarily will be driven by changes to IIT withholdings occurring on January 1, 2025. Withholdings typically comprise approximately 70% of overall collections, implying a reduction in cash collections over the latter half of FY 25 of approximately $334 million.

Discussion of Specific Provisions

Flat 3% Rate, Increased Standard Deductions & Retirement Exemption, Repealed Personal Exemptions:
Overall IIT liability changes due to the rate reductions, standard deduction and 65+ income exemption increases, and repeal of certain exemptions are modeled using partially-aggregated 2022 tax return data. LFO estimates of the likely impact of these features of the proposed bill are a nearly full year effect in FY 26 of $1.15 billion, and a full-year effect of approximately $1.33 billion in FY 27.

Annual CPI-U adjustment for exemptions and standard deductions:
This feature of the proposal will reduce overall IIT revenue further in every subsequent year, relative to the rate and deduction changes estimated in the previous section. In a scenario where CPI-U inflation were 3% in all years in the fiscal note horizon, this component would reduce collections by approximately an additional $26 million in FY 27, $52 million in FY 28, and so on.

New Bonus Depreciation:
LFO has no reliable basis for an estimate of the impact magnitude for this proposed exemption. For the purpose of this analysis, LFO assumes that this feature of the proposal will approximately offset the repealed deductions in the following section. **(continued on Page 2)**

Senate	Dual Referral Rules	House
[x]	13.5.1 >= $100,000 Annual Fiscal Cost {S & H}	[x] 6.8(F)(1) >= $100,000 SGF Fiscal Cost {H & S}
[x]	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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CONTINUED EXPLANATION from page one:

Net Capital Gains Deduction & I.R.C. Section 280C Repeal:
These deductions have typically amounted to between $40-$85 million and $1-$20 million, respectively, in recent years. For the purpose of this analysis, LFO assumes that this feature of the proposal will approximately offset the repealed deductions in the previous section.

New Trigger Provisions:
This proposal makes significant changes to the existing IIT rate trigger language in statute. The provisions in proposed law will likely serve to increase the likelihood of future revenue losses, due to thresholds that are ultimately attained more easily than those in current law. Existing features of IIT triggers in current law are repealed, including the existing requirement for IIT collections, the requirement for total taxes, licenses, and fee collections, and the requirement for Budget Stabilization Fund monies.

The repealed trigger thresholds are replaced with a single hurdle, based on SGF collections.

"Actual general fund revenues," as defined by the bill, are to be compared to "base year revenues," which is specified as $12,155,100,000 for purposes of the initial trigger assessment on October 1, 2026. This trigger would be reassessed every subsequent October 1. If automatic IIT rate cuts are triggered, they take effect immediately the following January.

The IIT rate would be reduced by 0.25% for every $374.0 million that actual general fund revenues exceed base year revenues. Both the base year amount of $12.2 billion and the $374.0 million threshold would be adjusted annually by the prior calendar year's CPI-U inflation, beginning at the trigger assessment in October 2027.

Effectively, **the bill requires a 0.25% rate reduction if actual SGF collections in FY 26 meet or exceed approximately $12.529 billion. Preliminary actual SGF collections for FY 24 appear to have been approximately $12.6 billion, so a revenue-neutral set of tax reforms that include this proposal would automatically cause a rate reduction in January 2027.** LFO notes that this trigger would effectively preclude the possibility of a tax reform package that is truly revenue-neutral beyond FY 27, relative to the tax code prior to the "fiscal cliff."

For informational purposes, a rough rule of thumb for the full-year impact of a 0.25% IIT rate cut would be a revenue impact of approximately -$250 million under the IIT regime in proposed law. Should actual SGF collections grow from $12.6 billion in FY 24 to $12.903 billion, a 0.5% rate reduction would result, implying a revenue impact of -$500 million.

Senate	Dual Referral Rules	House
[x]	13.5.1 >= $100,000 Annual Fiscal Cost {S & H}	[x] 6.8(F)(1) >= $100,000 SGF Fiscal Cost {H & S}
[x]	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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