

**Joint Legislative Budget Committee**  
**Staff Memorandum**

1716 West Adams  
Phoenix, Arizona 85007

Telephone: (602) 926-5491  
azleg.gov

---

DATE: May 26, 2021

TO: Richard Stavneak, Director

FROM: Hans Olofsson, Chief Economist

SUBJECT: DISTRIBUTIONAL IMPACT OF 2.5% TAX PROPOSAL

This memo responds to requests that we have received for the distributional impact by income level of the 2.5% tax proposal combined with the 4.5% rate cap on taxable income above \$250,000 for single filers and \$500,000 for married couples filing jointly.

The percentage reduction in total individual income tax liability for tax filers in 14 separate income groups, is shown in *Table 1* on the following page. The average reduction per filer (in dollars) for the same 14 income groups is shown in *Table 2*.

The estimates in *Table 1* and *Table 2* 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.

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' Tax Year (TY) 2021 liability. As noted above, we utilized DOR's microsimulation model of more than 50,000 tax returns for the implementation costs of the tax reduction, which tends to provide a more accurate assessment of the fiscal impacts. 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 2.5% rate is implemented in TY 2023 (FY 2024).

HO:kp

(Continued)

**JLBC**

**Table 1**

**Individual Income Tax Liability by Income Level**  
**[Millions of Dollars]**

A	B	C	D	E	F = E/C	G = E/D
<u>Federal AGI</u>	# Filers*	<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>
<b>TOTAL</b>	<b>3,066,540</b>	<b>\$5,508.2</b>	<b>\$6,309.9</b>	<b>\$4,540.3</b>	<b>-17.6%</b>	<b>-28.0%</b>

\* Includes residential filers only. DOR model does not provide distributional impact of nonresident filers. DOR estimates that nonresidential filers add 7.53% to the total liability shown in the table above.

\*\* Proposal: 2.5% regular rate with combined regular/208 rate capped at 4.5% for taxable income above \$250,000/\$500,000. The impact of the \$50 increase of the dependent tax credit is not reflected in the table above.

(Continued)

**Table 2**

**Average Individual Income Tax Liability Per Filer by Income Level**

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

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

\*\* Proposal: 2.5% regular rate with combined regular/208 rate capped at 4.5% for taxable income above \$250,000/\$500,000. The impact of the \$50 increase of the dependent tax credit is not reflected in the table above.