State Revenue Estimates of Federal Tax Legislation Conformity

If the state conforms to recently enacted federal tax law changes, we estimate that the state would generate $133.5 million in FY 2019 state General Fund revenue. This estimate, however, is highly speculative. 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

- The federal tax legislation 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 were effective January 1, 2018 and sunset January 1, 2026.
- 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.

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 "deconforming", however, those provisions would be subject to Proposition 108.

Estimated Impact

- Conforming to the recent federal tax legislation is estimated to result in a $133.5 million net increase to state General Fund revenues in FY 2019. *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 $173.9 million in revenue increases for individuals. Of that amount, an estimated $138.4 million reflects the revenue impact for changes to itemized deductions. That estimate is largely derived from a Department of Revenue (DOR) tax simulation model. While the $138.4 million estimate is not separated by itemized deduction provision, we believe much of the revenue impact would result from a $10,000 cap on state and local tax deductions and the repeal of a deduction for qualifying miscellaneous business and employee expenses above 2% of income. The JLBC Staff has requested additional estimate detail from DOR for provisions affecting itemized deductions.
- 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.

- 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:
  - <u>Bonus Depreciation</u>: 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 $133.5 million to $65.1 million.
  - <u>Medical Expenses</u>: 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.
  - <u>Foreign Income</u>: 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.
- Most federal changes are effective January 1, 2018. Given tax filing patterns, the JLBC Staff assumes that state conformity impacts will begin in FY 2019.
- The Department of Revenue (DOR) projects 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, or $102.7 million more than estimated by the JLBC Staff. The differences are summarized by major provision in *Attachment 2*.

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 estimates. To develop an Arizona estimate for many provisions, we prorated the nationwide estimate. In general, Arizona's estimated 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 uses a sample of taxpayer data from tax year (TY) 2014, which the agency then grows to approximate the base of taxpayers in TY 2018. The JLBC Staff estimates include the following adjustments:
    - Model estimates were reduced (10)% to account for uncertainty in scaling TY 2014 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.
- Some conformity provisions that are listed in *Attachment 1* of this report are not listed in DOR's conformity report. The JLBC Staff is working with DOR to confirm whether all provisions in *Attachment 1* represent conformity issues. If it is determined that some provisions materially affect our conformity estimates, this report will be revised accordingly.

State Conformity Revenue Estimates by Federal Provision

#	Provision 1/	Changes to Federal Law	Tax	Effective	General Fund Impact ($ in Millions) FY 2019 2/	Source
INDIVIDUAL PROVISIONS						
1	Repeal or modify itemized deductions below:				$ 138.4	DOR Conformity Report; JLBC Modified 3/
	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		
	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. • The federal legislation 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		
	Temporarily set medical expense deduction threshold at 7.5%	• In TY 2016, the federal deduction for out-of-pocket medical costs is available for expenses above 10% of federal adjusted gross income for taxpayers under 65 years of age and for expenses above 7.5% of income for those 65 years and older. Qualifying deductible expenses include most out-of-pocket physical care, behavioral health, dental, and vision expenses. • The legislation sets the threshold for all taxpayers at 7.5% in TY 2017 and TY 2018. • The state already deconforms and permits a deduction of all medical expenses. This analysis assumes the full state deduction continues.	IIT	TY 2017 and TY 2018		
	Repeal deduction for home equity loan interest and limit deduction of mortgage interest	• Repeals the deduction of interest paid on up to $100,000 of home equity loan debt, regardless of the date the loan was taken. • Lowers the amount of mortgage debt for which interest payments can be deducted, from $1 million to $750,000, for mortgages originated after 2017.	IIT	TY 2018 to TY 2025		
	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. • Federal legislation removes the limit on total itemized deductions.	IIT	TY 2018 to TY 2025		
	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		
	Repeal charitable contribution deduction for athletic event seating	• Repeals a deduction permitted for donations made to an educational institution to secure the right to purchase athletic event tickets.	IIT	TY 2018 and after		

State Conformity Revenue Estimates by Federal Provision

#	Provision 1/	Changes to Federal Law	Tax	Effective	General Fund Impact ($ in Millions) FY 2019 2/	Source
INDIVIDUAL PROVISIONS CONTINUED						
1 Cont.	Limit deduction for wagering losses	• Limits deduction for gambling losses and expenses incurred in wagering transactions to the individual's amount of winnings. Currently, the limit only applies to deductions for gambling losses.	IIT	TY 2018 to TY 2025		
	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. • Further denies deductions of any payment or cost incurred at the direction of a government for violation of a law and paid to a third party.	IIT	December 22, 2017		
	Modify deduction for property casualty losses	• Repeals the current deduction of non-disaster property losses arising from fire, storm, theft, shipwreck or other casualty. Continues to permit a deduction for unreimbursed property casualty losses incurred during a disaster, as declared by the U.S. President.	IIT	TY 2018 to TY 2025		
2	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. • The federal legislation 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	JCT prorated 4/
3	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 subtraction is retained for active duty military. The $1.7 million estimate was not adjusted for this retention.	IIT	TY 2018 to TY 2025	$ 1.7	DOR FY 13/FY14 Tax Expenditure Report; JLBC grew impact to FY 19 5/
4	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	JCT prorated 4/
5	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). • Federal legislation imposes a 3-year holding period of such distributions in order to qualify as long-term capital gains and reduced federal tax rates.	IIT	TY 2018 and after	$ 0.4	JCT prorated 4/
6	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. • Federal legislation repeals the deferral of capital gains income for sales of securities after 2017.	IIT/CIT	TY 2018 and after	$ 0.4	JCT prorated 4/
7	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	JCT prorated 4/

State Conformity Revenue Estimates by Federal Provision

#	Provision 1/	Changes to Federal Law	Tax	Effective	General Fund Impact ($ in Millions) FY 2019 2/	Source
INDIVIDUAL PROVISIONS CONTINUED						
8	Repeal rule to recharacterize contributions and conversions between Traditional and Roth IRAs	• Under federal changes, 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 +	JCT prorated 4/
9	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 +	JCT prorated 4/
10	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.) • Federal legislation 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 -	JCT prorated 4/
11	Permit rollovers from 529 savings accounts to ABLE accounts	• Federal legislation 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 -	JCT prorated 4/
12	Increase ABLE account contribution limit for amounts contributed by beneficiaries	• Previously, donors could contribute up to $14,000 annually to Achieving a Better Life Experience accounts for funding qualified expenses of disabled beneficiaries. • Federal legislation permits an additional contribution by account beneficiaries, above the $14,000 contributed by benefactors, equal to the lesser of the federal poverty level for an individual or the contributor's earnings for the year.	IIT	TY 2018 to TY 2025	Minimal -	JCT prorated 4/
13	Exclude forgiven student loan debt discharged due to death or disability	• Provides a new exclusion of debt discharged as a result of death or total disability of the borrower. Effective for debt discharged after 2017.	IIT	TY 2018 to TY 2025	Minimal -	JCT prorated 4/
14	Extend combat zone tax benefits to individuals working in Sinai Peninsula of Egypt	• Members of the armed forces serving in a designated combat zone are provided several tax benefits. • Federal legislation extends the same tax benefits to individuals working in the Sinai Peninsula of Egypt.	IIT	June 9, 2015 to TY 2025	Minimal -	JCT prorated 4/
	SUBTOTAL: INDIVIDUAL PROVISIONS				**$ 173.9**	

State Conformity Revenue Estimates by Federal Provision

#	Provision 1/	Changes to Federal Law	Tax	Effective	General Fund Impact ($ in Millions) FY 2019 2/	Source
BUSINESS PROVISIONS						
15	Increase business expensing allowance	• Previously, businesses could expense up to $500,000 of equipment in the year of investment, in addition to any amount under regular depreciation schedules. Expensing allows you to subtract the equipment cost from taxable income. The allowance began to phase out for 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.) • The federal legislation increases the business expensing allowance to $1 million, raises the phase-out threshold to $2.5 million, and indexes those amounts to inflation. Also expands qualifying property to lodging and certain improvements to non-residential real property.	IIT/CIT	TY 2018 and after	$ (24.1)	JCT prorated 4/
16	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 entities, but not corporations.) • Under the legislation, 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. (JLBC estimate does not attempt to score this provision). • Estimates assume the state only continues to conform for pass-through entities. If the state also extends the 100% allowance to C corporations, the state revenue reduction would increase $(68.4) million, to $(90.9) million. 7/	IIT	For investments after 9/27/2017	$ (22.5)	JLBC 6/
17	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)	JCT prorated 4/
18	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, the legislation 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	JCT prorated 7/
19	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	JCT prorated 7/

State Conformity Revenue Estimates by Federal Provision

#	Provision 1/	Changes to Federal Law	Tax	Effective	General Fund Impact ($ in Millions) FY 2019 2/	Source
BUSINESS PROVISIONS CONTINUED						
20	Deferral or elimination of taxes owed on capital gains reinvested in Opportunity Zones	• The federal legislation 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)	JCT prorated 4/
21	Limit net operating loss deduction	• Previously, businesses could carry forward 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 of net operating loss deductions for corporations than used at the federal level). • Under the legislation: ○ 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. • JLBC estimate reflects net operating loss conformity for individual taxpayers. The JCT prorated estimate has also been adjusted to reflect that the state does not permit carrybacks.	IIT	TY 2018 and after	$ 3.9	JCT prorated 4/ and JLBC modified
22	Repeal and modify deductions for expenses of certain fringe benefits	• Repeals current 50% deduction for expenses of entertainment, recreation, and organizational membership 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	JCT prorated 7/
23	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	JCT prorated 7/
24	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)	JCT prorated 4/
25	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	JCT prorated 7/
26	Repeal exceptions to $1 million compensation deduction limit	• Businesses may deduct up to $1 million of an employee's compensation as a business expense. Prior to the legislation, the $1 million cap did not apply to stock options, commissions, payments to retirement plans, and other items. • The legislation 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	JCT prorated 7/
27	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. • The legislation limits deferral of tax to exchanges of real property.	CIT/IIT	TY 2018 and after	$ 0.8	JCT prorated 7/

State Conformity Revenue Estimates by Federal Provision

#	Provision 1/	Changes to Federal Law	Tax	Effective	General Fund Impact ($ in Millions) FY 2019 2/	Source
BUSINESS PROVISIONS CONTINUED						
28	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	JCT prorated 4/
29	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)	JCT prorated 7/
30	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. • The legislation 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	JCT prorated 7/
31	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	JCT prorated 7/
32	Modify definitions of certain property for depreciation purposes	• Under federal legislation, qualified restaurant and retail improvement property are considered qualified improvement property subject to a 15-year recovery period.	CIT/IIT	TY 2018 and after	$ (0.2)	JCT prorated 7/
33	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	JCT prorated 7/
34	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. The legislation permits the interest expenses to be deducted during the production period.	CIT/IIT	TY 2018 and TY 2019	Minimal -	JLBC
35	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 +	JCT prorated 4/
36	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 +	JCT prorated 7/
37	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 -	JCT prorated 4/
38	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 -	JCT prorated 4/
39	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 -	JCT prorated 4/

State Conformity Revenue Estimates by Federal Provision

#	Provision 1/	Changes to Federal Law	Tax	Effective	General Fund Impact ($ in Millions) FY 2019 2/	Source
BUSINESS PROVISIONS CONTINUED						
40	Requires research and experimentation expenses to be depreciated over 5 years	• Currently, companies may deduct certain research and experimentation costs in the year of expense or depreciate the investment over time. • For research and experimentation expenses after 2022, repeals the option for full first year expensing and requires expenses to be depreciated over 5 years.	CIT/IIT	TY 2022 and after	-	JCT prorated 7/
	SUBTOTAL: BUSINESS PROVISIONS				**$ (40.4)**	
	TOTAL: INDIVIDUAL AND BUSINESS PROVISIONS				**$ 133.5**	

1/ Some provisions listed in this report are not listed in DOR's conformity report. The JLBC Staff is confirming with DOR whether any provisions listed in this table do not represent a conformity issue. If it is determined that some provisions materially affect our estimates, this report will be revised accordingly.

2/ 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 chart also includes the following estimates:
a) "Minimal +" = minimal revenue increase
b) "Minimal -" = minimal revenue decrease

3/ Using an individual income tax simulation model, DOR estimates that changes to itemized deductions under provision 1 would increase state revenues by a total of $170.8 million in FY 2019. The agency's estimate does not incorporate an exclusion provided for business taxes in calculating allowable deductions of state and local taxes under federal reforms. The 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)%. We have requested that DOR separately estimate the impact of major itemized deduction provisions.

4/ Arizona prorated 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 individual income tax liability (TY 2015 data). Estimates derived from this proration method are speculative. To produce a more cautious estimate, negative revenue impacts were increased 25% while positive impacts were reduced 25%.

5/ DOR reports in their FY 2013/2014 tax expenditure report that 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/ Estimate is based on prior-year staff estimates that increasing the bonus depreciation allowance for individual taxpayers to 50% of qualifying investments would reduce revenues by $(18.0) million. The JLBC Staff assumes that further increasing the allowance for bonus depreciation to 100% would further reduce state revenues by $(18.0) million. To produce a more cautious estimate, this negative revenue impact was increased 25%.

7/ Arizona prorated 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 proration method are speculative. To produce a more cautious estimate, negative revenue impacts were increased 25% while positive impacts were reduced 25%.

Attachment 2

DOR and JLBC Conformity Estimates by Major Provision

Federal Provision	FY 2019 General Fund Impact ($ in Millions) DOR	JLBC 1/	DOR - JLBC
INDIVIDUAL PROVISIONS			
Repeal or modify select itemized deductions (primarily $10,000 cap on state and local taxes deduction and repeal of miscellaneous expenses deduction)	$ 170.8	$ 138.4 2/	$ 32.4
Limit pass through of a business loss to offset other individual income	52.5	31.6	20.9
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: INDIVIDUAL PROVISIONS	**$ 228.4**	**$ 173.9**	**$ 54.4**
BUSINESS PROVISIONS			
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 to 30% of earnings	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	-	5.9
SUBTOTAL: BUSINESS PROVISIONS	**$ 7.8**	**$ (40.4)**	**$ 48.3**
TOTAL INDIVIDUAL AND BUSINESS PROVISIONS	**$ 236.2**	**$ 133.5**	**$ 102.7**

1/ Due to uncertainty about the accuracy of estimated impacts, initial calculations made by the JLBC Staff were adjusted to produce more cautious estimates. Except where otherwise noted, negative revenue estimates were increased 25% while positive estimates were reduced 25% from initial JLBC Staff estimates.

2/ 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 for state and local tax deductions. The modified estimate was then reduced 10% to recognize the uncertainty involved in projecting FY 2019 impacts using TY 2014 taxpayer data.