TENNESSEE GENERAL ASSEMBLY
FISCAL REVIEW COMMITTEE

FISCAL MEMORANDUM

HB 1367 – SB 1427

April 1, 2014

SUMMARY OF ORIGINAL BILL: Reduces the Hall Income Tax (HIT) rate from six percent to 4.75 percent for tax year 2015; to 3.92 percent for tax year 2016; to 3.36 percent for tax year 2017; and to 2.25 percent on or after January 1, 2018. Changes the local government distribution rate, after any deductions for necessary administrative expenses, from 37.5 percent to 47.40 percent for tax year 2015; to 57.40 percent for tax year 2016; to 67.00 percent for tax year 2017; and to 100.00 percent on or after January 1, 2018.

FISCAL IMPACT OF ORIGINAL BILL:

Decrease State Revenue – Net Impact – $52,400,100/FY15-16
$87,091,700/FY16-17
$110,598,000/FY17-18
$157,021,500/FY18-19 and Subsequent Years

Increase Local Revenue – Net Impact – $806,300/FY15-16
$1,239,700/FY16-17
$1,632,000/FY17-18
$2,240,200/FY18-19 and Subsequent Years

Other Fiscal Impact – Secondary economic impacts may occur as a result of this bill. Such impacts may be realized due to changes in population or as a result of other behavioral changes prompted by the passage of this bill. Due to multiple unknown factors, fiscal impacts directly attributable to such secondary economic impacts cannot be quantified with reasonable certainty.

SUMMARY OF AMENDMENT (015647): Deletes all language after the enacting clause. Establishes that in any year, beginning with FY14-15, in which state revenue growth meets or exceeds population growth-plus-inflation growth, the Hall Income Tax (HIT) rate will be reduced by one percentage point on January 1 for the following year; except, that when the rate is reduced to 3.00 percent and in the event state revenue growth meets or exceeds population growth-plus-inflation growth after such reduced rate becomes effective, then the subsequent reduction the rate of 3.00 percent shall be 0.75 percent. Requires the rate to remain at 2.25 percent, once it reaches that level, until further amended by the General Assembly. Requires the Commissioner of Finance and Administration (F&A), in consultation with the Commissioner of Revenue, on June 15 of any such fiscal year, to certify the amount of the state tax revenue collected for the then current fiscal year and notify the Governor, Speakers of the Senate and

House of Representatives, State Treasurer, and the Commissioner of Revenue of such amount, including the amount of any surplus state tax revenue collected. Requires the Commissioner of F&A to publish, by September 1 immediately following the certification, the HIT rate at which the income derived from stocks and dividends shall be taxed beginning on January 1 of the next calendar year. Changes the local government distribution rate, after any deductions for necessary administrative expenses, from 37.50 percent to: 45.00 percent when the HIT rate is 5.00 percent; 56.25 percent when the HIT rate is 4.00 percent; 75.00 percent when the HIT rate is 3.00 percent; and 100.00 percent when the HIT rate is 2.25 percent.

FISCAL IMPACT OF BILL WITH PROPOSED AMENDMENT:

Decrease State Revenue – Net Impact –
$41,867,200/FY16-17
$83,751,700/FY17-18
$126,004,600/FY18-19
$157,021,500/FY19-20 and Subsequent Years

State Expenditures – Cost Avoidance – $400,000/FY20-21 and Subsequent Years

Increase Local Revenue – Net Impact –
$592,200/FY16-17
$1,201,700/FY17-18
$2,179,600/FY18-19
$2,240,200/FY19-20 and Subsequent Years

Other Fiscal Impact – Secondary economic impacts may occur as a result of this bill. Such impacts may be realized due to changes in population or as a result of other behavioral changes prompted by the passage of this bill. Due to multiple unknown factors, fiscal impacts directly attributable to such secondary economic impacts cannot be quantified with reasonable certainty.

Any change in the fiscal impact as a result of state revenue growth not meeting or exceeding population growth-plus-inflation growth will be contingent upon the specific fiscal year in which such growth was not met, and the apportionment rate for local government for any such fiscal year. The fiscal impact for the bill as amended in such instances will be significant to both state and local government; however, any such fiscal impacts cannot be quantified.

Assumptions for the bill as amended:

- Pursuant to Tenn. Code Ann. § 67-2-102, HIT is a six percent tax on income derived from dividends on stock or from interest on bonds.
- It is assumed that the state revenue growth will meet or exceed population growth-plus-inflation growth for each fiscal year, beginning with FY14-15.

- The tax changes shall be applied to tax years beginning with tax year 2016, and assuming that 100 percent of HIT owed for tax year 2016 under current law would be collected no later than June 30, 2017, the first year impacted by this bill will be FY16-17. This collection pattern is assumed to remain constant into perpetuity under current law.
- Pursuant to Tenn. Code Ann. § 67-2-119(a), the state retains 62.50 percent of HIT revenue and local governments are apportioned 37.50 percent, after any deductions for necessary expenses for administration.
- Based on the apportionments of HIT collections for the last three fiscal years (FY10-11, FY11-12, and FY12-13), it is estimated that the state retains 65.19 percent of HIT revenue and local governments are apportioned 34.81 percent of the total HIT amounts collected, which is equivalent to 92.83 percent (34.81% / 37.50%) of the specified rate after deductions for necessary administrative expenses.
- The effective rate of distribution to the local government under this bill as amended will be: 41.77 percent when the HIT rate is 5.00 percent (45.00% x 92.83%), 52.22 percent when the HIT rate is 4.00 percent (56.25% x 92.83%), 69.62 percent when the HIT rate is 3.00 percent (75.00% x 92.83%), and 92.83 percent when the HIT rate is 2.25 percent (100.00% x 92.83%).
- The current Fiscal Review Committee estimate for HIT collections in FY14-15 is $260,000,000, of which $169,494,000 is the state portion ($260,000,000 x 65.19%), and $90,506,000 is the local government portion ($260,000,000 x 34.81%). These numbers are assumed to remain constant in subsequent years under current law.
- Fifty percent of tax savings will be spent in the economy on other sales-taxable goods and services.
- The current state sales tax rate is 7.00 percent; the average local option sales tax rate is estimated to be 2.50 percent.
- Pursuant to Tenn. Code Ann. § 67-6-103(a)(3)(A), local governments receive 4.603 percent of state sales tax revenue as state-shared sales tax revenue.
- Pursuant to Tenn. Code Ann. § 67-6-103(q), no portion of revenue derived from the 0.5 percent sales tax rate increase, from 5.5 percent to 6.0 percent (effective April 1, 1992), or the 1.0 percent sales tax rate increase, from 6.0 percent to 7.0 percent (effective July 15, 2002), shall be distributed to local government.
- The effective rate of apportionment to local government pursuant to the state-shared allocation is estimated to be 3.617% [(5.5%/7.0%) x 4.603%].

Assumptions related to FY16-17:

- The decrease in HIT revenue for the state in FY16-17 is estimated to be $43,329,000 [169,494,000 – ($260,000,000 / 6.00% x 5.00% x (100.00% - 41.77%))].
- The decrease in HIT revenue for the local government in FY16-17 is estimated to be $4,333 [$90,506,000 – ($260,000,000 / 6.00% x 5.00% x 41.77%)].
- The total tax savings are estimated to be $43,333,333 ($43,329,000 + $4,333).
- The net increase in state sales tax revenue in FY16-17 is estimated to be $1,461,809 [($43,333,333 x 50.00% x 7.00%) - ($43,333,333 x 50.00% x 7.00 x 3.617%)].
- The total increase in local sales tax revenue in FY16-17 is estimated to be $596,525 [($43,333,333 x 50.00% x 2.50%) + ($43,333,333 x 50.00% x 7.00 x 3.617%)].

- The net decrease in state revenue as a result of this bill in FY16-17 is estimated to be $41,867,191 ($43,329,000 - $1,461,809).
- The net increase in local revenue as a result of this bill in FY16-17 is estimated to be $592,192 ($4,333 - $596,525).

Assumptions related to FY17-18:

- The decrease in HIT revenue for the state in FY17-18 is estimated to be $86,675,333 [$169,494,000 – ($260,000,000 / 6.00% x 4.00% x (100.00% - 52.22%))].
- The increase in HIT revenue for the local government in FY17-18 is estimated to be $8,667 [$90,506,000 – ($260,000,000 / 6.00% x 4.00% x 52.22%)].
- The total tax savings are estimated to be $86,666,667 ($86,675,333 - $8,667).
- The net increase in state sales tax revenue in FY17-18 is estimated to be $2,923,617 [($86,666,667 x 50.00% x 7.00%) - ($86,666,667 x 50.00% x 7.00 x 3.617%)].
- The total increase in local sales tax revenue in FY17-18 is estimated to be $1,193,049 [($86,666,667 x 50.00% x 2.50%) + ($86,666,667 x 50.00% x 7.00 x 3.617%)].
- The net decrease in state revenue as a result of this bill in FY17-18 is estimated to be $83,751,715 ($86,675,333 - $2,923,617).
- The total increase in local revenue as a result of this bill in FY17-18 is estimated to be $1,201,716 ($8,667 + $1,193,049).

Assumptions related to FY18-19:

- The decrease in HIT revenue for the state in FY18-19 is estimated to be $130,390,000 [$169,494,000 – ($260,000,000 / 6.00% x 3.00% x (100.00% - 69.62%))].
- The increase in HIT revenue for the local government in FY18-19 is estimated to be $390,000 [$90,506,000 – ($260,000,000 / 6.00% x 3.00% x 69.62%)].
- The total tax savings are estimated to be $130,000,000 ($130,390,000 - $390,000).
- The net increase in state sales tax revenue in FY18-19 is estimated to be $4,385,427 [($130,000,000 x 50.00% x 7.00%) - ($130,000,000 x 50.00% x 7.00 x 3.617%)].
- The total increase in local sales tax revenue in FY18-19 is estimated to be $1,789,574 [($130,000,000 x 50.00% x 2.50%) + ($130,000,000 x 50.00% x 7.00 x 3.617%)].
- The net decrease in state revenue as a result of this bill in FY18-19 is estimated to be $126,004,573 ($130,390,000 - $4,385,427).
- The total increase in local revenue as a result of this bill in FY18-19 is estimated to be $2,179,574 ($390,000 + $1,789,574).

Assumptions related to FY19-20 and subsequent years:

- The decrease in HIT revenue for the state in FY19-20 and subsequent years is estimated to be $162,503,250 [$169,494,000 – ($260,000,000 / 6.00% x 2.25% x (100.00% - 92.83%))].
- The increase in HIT revenue for the local government in FY19-20 and subsequent years is estimated to be $3,250 [$90,506,000 – ($260,000,000 / 2.25% x 3.92% x 92.83%)].
- The total tax savings are estimated to be $162,500,000 ($162,503,250 - $3,250).

- The net increase in state sales tax revenue in FY19-20 and subsequent years is estimated to be $5,481,784 [($162,500,000 x 50.00% x 7.00%) - ($162,500,000 x 50.00% x 7.00 x 3.617%)].
- The total increase in local sales tax revenue in FY19-20 and subsequent years is estimated to be $2,236,967 [($162,500,000 x 50.00% x 2.50%) + ($162,500,000 x 50.00% x 7.00 x 3.617%)].
- The net decrease in state revenue as a result of this bill in FY19-20 and subsequent years is estimated to be $157,021,466 ($162,503,250 - $5,481,784).
- The total increase in local revenue as a result of this bill in FY19-20 and subsequent years is estimated to be $2,240,217 ($3,250 + $2,236,967).

Assumptions related to expenditures and secondary economic impacts:

- The Department of Revenue will redeploy all six HIT auditors to other tax audit areas once HIT is fully phased out. The number of auditors that the Department intends to recruit will, therefore, decrease by six, resulting in a recurring cost avoidance of approximately $400,000, beginning in FY20-21. Due to filing extensions and late filings, all auditors will remain in the HIT division through FY19-20.
- There could be subsequent increases in state and local government revenue and expenditures due to the secondary economic impacts prompted by the passage of this bill. Increases in expenditures may occur if the demand for governmental programs and infrastructure increases as a result of population increases. Due to multiple unknown factors such as the extent and timing of population changes, the fiscal impacts directly attributable to such secondary economic impacts cannot be quantified with reasonable certainty.

CERTIFICATION:

The information contained herein is true and correct to the best of my knowledge.

Lucian D. Geise, Executive Director

/bos