

TENNESSEE GENERAL ASSEMBLY
FISCAL REVIEW COMMITTEE



FISCAL NOTE

HB 1698 - SB 1816

March 2, 2014

SUMMARY OF BILL: Exempts from the Hall Income Tax (HIT) any income derived from any stock in any bank holding company doing business in Tennessee that is classified as a Subchapter S corporation, and the holding company wholly owns the subsidiary, bank or banks, doing business in Tennessee. Requires any income derived from a non-bank subsidiary to still be subject to HIT.

ESTIMATED FISCAL IMPACT:

Decrease State Revenue – Net Impact – \$952,100/FY14-15
\$2,114,600/FY15-16
\$2,348,200/FY16-17 and Subsequent Years

Decrease Local Revenue – Net Impact – \$514,900/FY14-15
\$1,143,700/FY15-16
\$1,270,000/FY16-17 and Subsequent Years

Assumptions:

- 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.
- Based on 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.
- According to the Department of Revenue (DOR), subchapter S bank holding companies have paid \$53,282,000 in dividends in 2013, a 37.5 percent increase over dividends paid in 2012. Of that amount, it is estimated that approximately \$1,914,930 was paid out to out-of-state shareholders that would not be subject to HIT.
- Further, the exact amount of dividends that would be exempt under current law pursuant to Tenn. Code Ann. § 67-2-104 is unknown, but reasonably estimated to be ten percent of the dividends paid out to Tennessee residents.
- The total amount of dividends paid in 2013 and subject to HIT is estimated to be \$46,230,363 [(\$53,282,000 - \$1,914,930) x 90.0%].
- According to DOR, the Capital Asset Pricing Model was used to derive the required rate of return for ten publicly-traded bank holding companies, which was then used, with current dividends and share prices in the Gordon Growth Model, to determine the future dividend growth expected by the market into perpetuity.

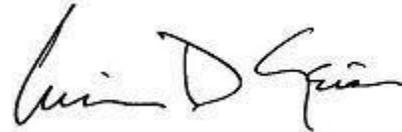
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- The future dividend growth rate is estimated to be 11.05 percent.
- Taxable dividends are estimated to be: \$51,338,818 ($\$46,230,363 \times 111.05\%$) in calendar year 2014 to be taxed in FY14-15; \$57,011,757 ($\$51,338,818 \times 111.05\%$) in calendar year 2015 to be taxed in FY15-16; \$63,311,556 ($\$57,011,757 \times 111.05\%$) in calendar year 2016 to be taxed in FY16-17; and will continue increasing by 11.05 percent annually into perpetuity.
- For the purposes of this fiscal note, any decrease occurring in revenue occurring in FY16-17 is assumed to remain constant into perpetuity.
- Given that the changes in this bill are effective July 1, 2014, any dividend or interest income received from January 1, 2014, through June 30, 2014, will be due by payable by April 15, 2015 at the tax rates codified under current law. Any dividend or interest income received from July 1, 2014, through December 31, 2014, will be exempt from HIT. Therefore, the first year impacted by this bill will be FY14-15 and the impact will be equal to 50 percent of the full-year impact.
- The resulting decrease in HIT revenue is estimated to be:
 - \$1,540,164 ($\$51,338,818 \times 6.0\% \times 50.0\%$) in FY14-15, of which \$1,004,033 will be the state portion and \$536,131 will be the local portion;
 - \$3,420,705 ($\$57,011,757 \times 6.0\%$) in FY15-16, of which \$2,229,958 will be the state portion and \$1,190,747 will be the local portion;
 - \$3,798,693 ($\$63,311,556 \times 6.0\%$) in FY16-17 and subsequent years, of which \$2,476,368 will be the state portion and \$1,322,325 will be the local portion.
- Fifty percent of tax savings will be spent in the economy on sales-taxable goods and services.
- The current state sales tax rate is 7.0 percent; the average local option sales tax rate is estimated to be 2.5 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% [$(5.5\%/7.0\%) \times 4.603\%$].
- The net increase in state sales tax revenue in FY14-15 is estimated to be \$51,956 [$(\$1,540,164 \times 50.0\% \times 7.0\%) - (\$1,540,164 \times 50.0\% \times 7.0\% \times 3.617\%)$].
- The total increase in local sales tax revenue in FY14-15 is estimated to be \$21,202 [$(\$1,540,164 \times 50.0\% \times 2.5\%) + (\$1,540,164 \times 50.0\% \times 7.0\% \times 3.617\%)$].
- The net decrease in state revenue as a result of this bill in FY14-15 is estimated to be \$952,077 ($\$1,004,033 - \$51,956$).
- The net decrease in local revenue as a result of this bill in FY14-15 is estimated to be \$514,929 ($\$536,131 - \$21,202$).
- The net increase in state sales tax revenue in FY15-16 is estimated to be \$115,395 [$(\$3,420,705 \times 50.0\% \times 7.0\%) - (\$3,420,705 \times 50.0\% \times 7.0\% \times 3.617\%)$].
- The total increase in local sales tax revenue in FY15-16 is estimated to be \$47,089 [$(\$3,420,705 \times 50.0\% \times 2.5\%) + (\$3,420,705 \times 50.0\% \times 7.0\% \times 3.617\%)$].

- The net decrease in state revenue as a result of this bill in FY15-16 is estimated to be \$2,114,563 (\$2,229,958 - \$115,395).
- The net decrease in local revenue as a result of this bill in FY15-16 is estimated to be \$1,143,658 (\$1,190,747 - \$47,089).
- The net increase in state sales tax revenue in FY16-17 and subsequent years is estimated to be \$128,145 [(\$3,798,693 x 50.0% x 7.0%) - (\$3,798,693 x 50.0% x 7.0% x 3.617%)].
- The total increase in local sales tax revenue in FY16-17 and subsequent years is estimated to be \$52,293 [(\$3,798,693 x 50.0% x 2.5%) + (\$3,798,693 x 50.0% x 7.0% x 3.617%)].
- The net decrease in state revenue as a result of this bill in FY16-17 and subsequent years is estimated to be \$2,348,223(\$2,476,368 - \$128,145).
- The net decrease in local revenue as a result of this bill in FY16-17 and subsequent years is estimated to be \$1,270,032 (\$1,322,325 - \$52,293).

CERTIFICATION:

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



Lucian D. Geise, Executive Director

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