

TENNESSEE GENERAL ASSEMBLY
FISCAL REVIEW COMMITTEE



**CORRECTED
FISCAL MEMORANDUM**

SB 47 – HB 813

February 16, 2016

SUMMARY OF ORIGINAL BILL: Establishes that in any year, beginning with FY14-15, in which state revenue growth exceeds three percent over the previous fiscal year, the Hall Income Tax (HIT) rate will be reduced by one percentage point on January 1 for the following calendar year; except that when the rate is reduced to three percent and in the event state revenue growth exceeds three percent over the previous fiscal year after such reduced rate becomes effective, then the subsequent reduction to the rate shall be three-fourths of one percent. 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, and State Treasurer of such amount, including the amount of any surplus state tax revenue collected. Requires the Commissioner of Revenue 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 of 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, 1.50 percent, or 0.75 percent. Defines “state revenue growth” as, for any tax year, the percentage increase in revenue derived from state taxes and collected by the state.

CORRECTED FISCAL IMPACT OF ORIGINAL BILL:

Decrease State Revenue – Net Impact –

\$43,468,500/FY17-18
\$86,954,900/FY18-19
\$130,445,900/FY19-20
\$163,054,000/FY20-21
\$164,139,600/FY21-22
\$165,225,200/FY22-23
\$166,310,800/FY23-24 and Subsequent Years

Decrease State Expenditures – \$500,000/FY24-25 and Subsequent Years

Increase Local Revenue – Net Impact –

\$606,000/FY17-18
\$1,229,900/FY18-19
\$1,858,400/FY19-20

SB 47 – HB 813 (CORRECTED)

\$2,319,600/FY20-21

Decrease Local Revenue – Net Impact –

\$28,741,600/FY21-22

\$59,802,900/FY22-23

\$90,864,200/FY23-24 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 exceeding three percent over the previous fiscal year will be contingent upon the specific fiscal year in which such growth was not exceeded, and the apportionment rate for local government for any such fiscal year. The fiscal impact for the bill in such instances will be significant to both state and local government; however, any such fiscal impacts cannot be quantified.

SUMMARY OF AMENDMENT (011837): Deletes all language of the original bill. Establishes that in any year, beginning with FY14-15, in which state revenue growth exceeds an average of three percent over the previous two consecutive fiscal years, the Hall Income Tax (HIT) rate will be reduced by one percentage point on January 1 for the following calendar year; except that when the rate is reduced to three percent and in the event state revenue growth exceeds three percent over the previous two consecutive fiscal years after such reduced rate becomes effective, then the subsequent reduction to the rate shall be 0.75 percent. Defines “state revenue growth” as a percentage increase in revenue derived from state taxes that are collected by the state and deposited in the General Fund.

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, 1.50 percent, or 0.75 percent.

Authorizes local governments to levy an identical HIT, but prohibits such tax from being levied prior to January 1 of the calendar year in which the rate of the tax imposed by the state is equal to or greater than 2.25 percent. Prohibits the sum of the tax rate levied by the local government and tax rate levied by the state from exceeding 2.25 percent. Requires the Department of Revenue to collect the tax on behalf of each local government levying the tax. Authorizes the Department to deduct necessary expenses for collecting the tax, prior to distributing revenue to local governments.

FISCAL IMPACT OF BILL WITH PROPOSED AMENDMENT:

On February 8, 2016, a fiscal memo was issued estimating a fiscal impact as follows:

Decrease State Revenue – Net Impact –

*\$43,468,500/FY17-18
\$86,954,900/FY18-19
\$130,445,900/FY19-20
\$163,054,000/FY20-21
\$164,139,600/FY21-22
\$165,225,200/FY22-23
\$166,310,800/FY23-24 and Subsequent Years*

Decrease State Expenditures – \$500,000/FY24-25 and Subsequent Years

Increase Local Revenue – Net Impact –

*\$606,000/FY17-18
\$1,229,900/FY18-19
\$1,858,400/FY19-20
\$2,319,600/FY20-21*

Decrease Local Revenue – Net Impact –

*\$28,741,600/FY21-22
\$59,802,900/FY22-23
\$90,864,200/FY23-24 and Subsequent Years*

Other Fiscal Impact – There could be a permissive recurring increase in local government revenue if local governments levy a HIT pursuant to this bill as amended. Due to many unknown factors, such as the number of local governments that will levy the tax, the average tax rate levied, the taxable base of persons subject to the tax, and the timing of any such levy, a precise fiscal impact to local government cannot be quantified with reasonable certainty.

Secondary economic impacts may occur as a result of this bill as amended. 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 exceeding three percent over the previous two consecutive fiscal years will be contingent upon the specific fiscal year in which such growth was not exceeded, 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.

The estimated fiscal impact incorrectly represented the impact to state expenditures. Based on additional review, the estimated impact is:

(CORRECTED)

Decrease State Revenue – Net Impact –

\$43,468,500/FY17-18
\$86,954,900/FY18-19
\$130,445,900/FY19-20
\$163,054,000/FY20-21
\$164,139,600/FY21-22
\$165,225,200/FY22-23
\$166,310,800/FY23-24 and Subsequent Years

Increase Local Revenue – Net Impact –

\$606,000/FY17-18
\$1,229,900/FY18-19
\$1,858,400/FY19-20
\$2,319,600/FY20-21

Decrease Local Revenue – Net Impact –

\$28,741,600/FY21-22
\$59,802,900/FY22-23
\$90,864,200/FY23-24 and Subsequent Years

Other Fiscal Impact – There could be a permissive recurring increase in local government revenue if local governments levy an income tax pursuant to this bill as amended. Due to multiple unknown factors, the extent of any permissive increase in local revenue pursuant to the levy of a local tax cannot be quantified with reasonable certainty. In addition, the extent to which any permissive increase in local revenue will offset the mandatory decrease in local revenue is unknown.

Secondary economic impacts may occur as a result of this bill as amended. 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 exceeding three percent over the previous two consecutive fiscal years will be contingent upon the specific fiscal year in which such growth was not exceeded, 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.
- General Fund cash collections grew 9.42 percent in FY14-15 over FY13-14. General Fund cash collections for the first five months of FY15-16 are 9.71 percent higher than cash collections for the first five months of FY14-15.
- Assuming that a similar trend continues for the remainder of the current fiscal year, it is determined that state revenue growth will exceed an average of three percent over the previous two consecutive fiscal years, beginning with FY15-16.
- The tax changes shall be applied to tax years beginning with tax year 2017, and assuming that 100 percent of HIT owed for tax year 2017 under current law would be collected no later than June 30, 2018, the first year impacted by this bill will be FY17-18. 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 (FY12-13, FY13-14, and FY14-15), it is estimated that the state retains 64.97 percent of HIT revenue and local governments are apportioned 35.03 percent of the total HIT amounts collected, which is equivalent to 93.41 percent ($35.03\% / 37.50\%$) of the specified rate after deductions for necessary administrative expenses.
- The effective rate of distribution to the local government under this bill will be: 42.03 percent when the HIT rate is 5.00 percent ($45.00\% \times 93.41\%$), 52.54 percent when the HIT rate is 4.00 percent ($56.25\% \times 93.41\%$), 70.06 percent when the HIT rate is 3.00 percent ($75.00\% \times 93.41\%$), and 93.41 percent when the HIT rate is 2.25 percent, 1.50 percent, or 0.75 percent ($100.00\% \times 93.41\%$).
- The current Fiscal Review Committee estimate for HIT collections in FY16-17 is \$270,000,000, of which \$175,419,000 is the state portion ($\$270,000,000 \times 64.97\%$), and \$94,581,000 is the local government portion ($\$270,000,000 \times 35.03\%$). 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 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; the effective rate of apportionment to local government pursuant to the state-shared allocation is estimated to be 3.617 percent.

Assumptions related to FY17-18:

- The decrease in HIT revenue for the state in FY17-18 is estimated to be \$44,986,500 [$\$175,419,000 - (\$270,000,000 / 6.00\% \times 5.00\% \times (100.00\% - 42.03\%))$].
- The decrease in HIT revenue for the local government in FY17-18 is estimated to be \$13,500 [$\$94,581,000 - (\$270,000,000 / 6.00\% \times 5.00\% \times 42.03\%)$].

- The total tax savings are estimated to be \$45,000,000 (\$44,986,500 + \$13,500).
- The net increase in state sales tax revenue in FY17-18 is estimated to be \$1,518,032 [(\$45,000,000 x 50.00% x 7.00%) – (\$45,000,000 x 50.00% x 7.00% x 3.617%)].
- The total increase in local sales tax revenue in FY17-18 is estimated to be \$619,468 [(\$45,000,000 x 50.00% x 2.50%) + (\$45,000,000 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 \$43,468,468 (\$44,986,500 - \$1,518,032).
- The net increase in local revenue as a result of this bill in FY17-18 is estimated to be \$605,968 (\$13,500 - \$619,468).

Assumptions related to FY18-19:

- The decrease in HIT revenue for the state in FY18-19 is estimated to be \$89,991,000 [\$175,419,000 – (\$270,000,000 / 6.00% x 4.00% x (100.00% - 52.54%))].
- The decrease in HIT revenue for the local government in FY18-19 is estimated to be \$9,000 [\$94,581,000 – (\$270,000,000 / 6.00% x 4.00% x 52.54%)].
- The total tax savings are estimated to be \$90,000,000 (\$89,991,000 + \$9,000).
- The net increase in state sales tax revenue in FY18-19 is estimated to be \$3,036,064 [(\$90,000,000 x 50.00% x 7.00%) – (\$90,000,000 x 50.00% x 7.00% x 3.617%)].
- The total increase in local sales tax revenue in FY18-19 is estimated to be \$1,238,936 [(\$90,000,000 x 50.00% x 2.50%) + (\$90,000,000 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 \$86,954,936 (\$89,991,000 - \$3,036,064).
- The net increase in local revenue as a result of this bill in FY18-19 is estimated to be \$1,229,936 (\$9,000 - \$1,238,936).

Assumptions related to FY19-20:

- The decrease in HIT revenue for the state in FY19-20 is estimated to be \$135,000,000 [\$175,419,000 – (\$270,000,000 / 6.00% x 3.00% x (100.00% - 70.06%))].
- The decrease in HIT revenue for the local government in FY19-20 is estimated to be \$0 [\$94,581,000 – (\$270,000,000 / 6.00% x 3.00% x 70.06%)].
- The total tax savings are estimated to be \$135,000,000 (\$135,000,000 + \$0).
- The net increase in state sales tax revenue in FY19-20 is estimated to be \$4,554,097 [(\$135,000,000 x 50.00% x 7.00%) – (\$135,000,000 x 50.00% x 7.00% x 3.617%)].
- The total increase in local sales tax revenue in FY19-20 is estimated to be \$1,858,403 [(\$135,000,000 x 50.00% x 2.50%) + (\$135,000,000 x 50.00% x 7.00% x 3.617%)].
- The net decrease in state revenue as a result of this bill in FY19-20 is estimated to be \$130,445,903 (\$135,000,000 - \$4,554,097).
- The net increase in local revenue as a result of this bill in FY19-20 is estimated to be \$1,858,403 (\$0 - \$1,858,403).

Assumptions related to FY20-21:

- The decrease in HIT revenue for the state in FY20-21 is estimated to be \$168,746,625 [$\$175,419,000 - (\$270,000,000 / 6.00\% \times 2.25\% \times (100.00\% - 93.41\%))$].
- The decrease in HIT revenue for the local government in FY20-21 is estimated to be \$3,375 [$\$94,581,000 - (\$270,000,000 / 6.00\% \times 2.25\% \times 93.41\%)$].
- The total tax savings are estimated to be \$168,750,000 ($\$168,746,625 + \$3,375$).
- The net increase in state sales tax revenue in FY20-21 is estimated to be \$5,692,621 [$(\$168,750,000 \times 50.00\% \times 7.00\%) - (\$168,750,000 \times 50.00\% \times 7.00\% \times 3.617\%)$].
- The total increase in local sales tax revenue in FY20-21 is estimated to be \$2,323,004 [$(\$168,750,000 \times 50.00\% \times 2.50\%) + (\$168,750,000 \times 50.00\% \times 7.00\% \times 3.617\%)$].
- The net decrease in state revenue as a result of this bill in FY20-21 is estimated to be \$163,054,004 ($\$168,746,625 - \$5,692,621$).
- The net increase in local revenue as a result of this bill in FY20-21 is estimated to be \$2,319,629 ($\$3,375 - \$2,323,004$).

Assumptions related to FY21-22:

- The decrease in HIT revenue for the state in FY21-22 is estimated to be \$170,970,750 [$\$175,419,000 - (\$270,000,000 / 6.00\% \times 1.50\% \times (100.00\% - 93.41\%))$].
- The decrease in HIT revenue for the local government in FY21-22 is estimated to be \$31,529,250 [$\$94,581,000 - (\$270,000,000 / 6.00\% \times 1.50\% \times 93.41\%)$].
- The total tax savings are estimated to be \$202,500,000 ($\$171,078,750 + \$31,421,250$).
- The net increase in state sales tax revenue in FY21-22 is estimated to be \$6,831,145 [$(\$202,500,000 \times 50.00\% \times 7.00\%) - (\$202,500,000 \times 50.00\% \times 7.00\% \times 3.617\%)$].
- The total increase in local sales tax revenue in FY21-22 is estimated to be \$2,787,605 [$(\$202,500,000 \times 50.00\% \times 2.50\%) + (\$202,500,000 \times 50.00\% \times 7.00\% \times 3.617\%)$].
- The net decrease in state revenue as a result of this bill in FY21-22 is estimated to be \$164,139,605 ($\$170,970,750 - \$6,831,145$).
- The net decrease in local revenue as a result of this bill in FY21-22 is estimated to be \$28,741,645 ($\$31,529,250 - \$2,787,605$).

Assumptions related to FY22-23:

- The decrease in HIT revenue for the state in FY22-23 is estimated to be \$173,194,875 [$\$175,419,000 - (\$270,000,000 / 6.00\% \times 0.75\% \times (100.00\% - 93.41\%))$].
- The decrease in HIT revenue for the local government in FY22-23 is estimated to be \$62,055,125 [$\$94,581,000 - (\$270,000,000 / 6.00\% \times 0.75\% \times 93.41\%)$].
- The total tax savings are estimated to be \$236,250,000 ($\$173,410,875 + \$62,839,125$).
- The net increase in state sales tax revenue in FY22-23 is estimated to be \$7,969,669 [$(\$236,250,000 \times 50.00\% \times 7.00\%) - (\$236,250,000 \times 50.00\% \times 7.00\% \times 3.617\%)$].

- The total increase in local sales tax revenue in FY22-23 is estimated to be \$3,252,206 $[(\$236,250,000 \times 50.00\% \times 2.50\%) + (\$236,250,000 \times 50.00\% \times 7.00\% \times 3.617\%)]$.
- The net decrease in state revenue as a result of this bill in FY22-23 is estimated to be \$165,225,206 $(\$173,194,875 - \$7,969,669)$.
- The net decrease in local revenue as a result of this bill in FY22-23 is estimated to be \$59,802,919 $(\$62,055,125 - \$3,252,206)$.

Assumptions related to FY23-24 and subsequent years:

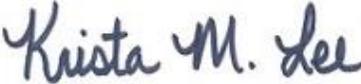
- The decrease in HIT revenue for the state in FY23-24 and subsequent years is estimated to be \$175,419,000, as the HIT will be fully eliminated.
- The decrease in HIT revenue for the local government in FY23-24 and subsequent years is estimated to be \$94,581,000, as the HIT will be fully eliminated.
- The total tax savings are estimated to be \$270,000,000 $(\$175,743,000 + \$94,257,000)$.
- The net increase in state sales tax revenue in FY23-24 and subsequent years is estimated to be \$9,108,193 $[(\$270,000,000 \times 50.00\% \times 7.00\%) - (\$270,000,000 \times 50.00\% \times 7.00\% \times 3.617\%)]$.
- The total increase in local sales tax revenue in FY23-24 and subsequent years is estimated to be \$3,716,807 $[(\$270,000,000 \times 50.00\% \times 2.50\%) + (\$270,000,000 \times 50.00\% \times 7.00\% \times 3.617\%)]$.
- The net decrease in state revenue as a result of this bill in FY23-24 and subsequent years is estimated to be \$166,310,807 $(\$175,419,000 - \$9,108,193)$.
- The net decrease in local revenue as a result of this bill in FY23-24 and subsequent years is estimated to be \$90,864,193 $(\$94,581,000 - \$3,716,807)$.

Assumptions related to expenditures and secondary economic impacts:

- The Department of Revenue will not eliminate any HIT audit positions once state-imposed HIT is fully phased out. The proposed legislation, as amended, requires the Department to collect the tax on behalf of each local government that elects to levy the tax.
- There could be a permissive recurring increase in local government revenue if local governments levy a HIT pursuant to this bill as amended. Due to many unknown factors, such as the number of local governments that will levy the tax, the average tax rate levied, the taxable base of persons subject to the tax, and the timing of any such levy, a precise fiscal impact cannot be quantified with reasonable certainty.
- 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 as amended. Increases in revenue may occur if the state's population increases as a result of reduced tax liability. 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.



Krista M. Lee, Executive Director

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