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TO: The Honorable Phillip R. DeVillier, Speaker of the House

FROM: Benjamin Vincent, Chief Legislative Economist
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DATE: October 8, 2024

SUBJECT: Preliminary Analysis of Draft Legislation – Corporate Income Tax (CIT): 3.5% Flat Rate, Termination of Applicability of Certain Credits

Summary

Expenditures	**2024-25**	**2024-25**	**2024-25**	**2024-25**	**2024-25**
State General Fund	0	0	0	0	0
Self-Generated Revenues	Increase	0	0	0	0
Dedications/Other	0	0	0	0	0
Federal Funds	0	0	0	0	0
Local Funds	0	0	0	0	0
Annual Total	0	0	0	0	0

Revenues	**2024-25**	**2025-26**	**2026-27**	**2027-28**	**2028-29**
State General Fund	See Below	See Below	See Below	See Below	See Below
Self-Generated Revenues	See Below	See Below	See Below	See Below	See Below
Dedications/Other	See Below	See Below	See Below	See Below	See Below
Federal Funds	0	0	0	0	0
Local Funds	0	0	0	0	0
Annual Total	**-$205,000,000**	**-$358,000,000**	**-$267,000,000**	**-$167,000,000**	**-$67,000,000**

Expenditure Explanation and Assumptions

LDR reports anticipated one-time expenditures for minor system design and specification updates, testing, and system development in support of tax return modifications and processing system modification. Anticipated costs total approximately $200,000.

Note: This analysis reflects bill draft serialized as “HLS 25RS-95 DRAFT 10/4/24 8:21 AM”

Revenue Explanation and Assumptions
The proposal referenced:

- Specifies a tax rate of 3.5% on all income that is subject to CIT taxation
- Repeals granting of certain credits unless earned prior to specified dates
- Repeals CIT applicability of certain (other) credits or exemptions with immediate effect
- Allows full expensing ("Bonus Depreciation") for certain capital investment, retroactive to certain activities beginning in January 2023
- Is applicable to CIT-taxable years beginning on or after January 1, 2025.
- Is applicable to CFT-taxable years beginning on or after January 1, 2026.

The overall fiscal impact of this proposal is affected by multiple moving parts, each subject to significant uncertainty. Each of the major components are discussed below, and the combination of these individual factors implies an overall **FY25 revenue impact of -$205 million, a FY26 impact of -$358 million, and a FY27 impact of -$267 million**, reflected in the table above.

Impacts are reflected as "Annual Totals", as some portion of the revenue impacts realized will be reflected as reduced dedications and reduced self-generated revenues.

Flat 3.5% Rate (Tax Liability Impact):

The corporate income tax liability change was modeled using returns filed for taxable year 2021, modified to reflect 2022 tax rates. Recent historical filing patterns indicate that 28% of payments due are collected in the year they are incurred, an additional 65% are collected in the subsequent year, and the remaining 7% are typically collected in the third year. The full (year 3) effect resulting from a single rate of 3.5% is an **estimated $612 million in reduced CIT liability**. Typical filing patterns would imply that this would result in a $171 million reduction in FY25, $569 million reduction in FY26, and a $612 million reduction in FY27 and subsequent years.

Certain Credits Immediately Disallowed:

The proposed bill repeals the applicability of several credits with immediate effect. These credits being disallowed are estimated to reduce CIT revenues by **approximately $145 million** under current law.

LFO assumes that the repeal of these items would materially offset revenue losses from the CIT rate reduction relatively quickly, reflected as a contribution of +$145 million in FY26 and subsequent years.

Certain Credits Terminating by Application or Certification Date:

The repeal of these items is <u>not</u> likely to materially increase net CIT collections immediately, as there is typically a significant lag between the time that such credits are granted and the time that they are ultimately claimed. Additionally, the proposal sets a future date after which no credits will be granted, which will likely engender a spike in the number of applications and notices prior to the deadline. All such outstanding credits would need to be paid out in order to fully realize the full revenue gain from this element of the proposed bill.

Credits (terminating by application date) that would no longer be authorized are anticipated to reduce CIT revenues by **approximately $500 million in FY25 under current law. A net CIT revenue increase of comparable magnitude would eventually occur due to disallowing new participation in January 2025. However, LFO believes that such an increase is unlikely to manifest fully within the 5-year fiscal note horizon**, as many outstanding credits will be applied against a smaller CIT tax base (due to the reduced rate). This factor contributes an assumed increasing annual portion of the estimated +$500 million; 20% in FY26, 40% in FY27, and so on, to the overall revenue impacts reflected above.

Existing Carryforwards of Refunds/Overpayments:

Approximately **$137 million of overpayments carried forward** exist that may be claimed against taxable periods after 12/31/2022. Reduced liabilities in taxable year 2025 may accelerate claims of these refunds, reducing FY25 net CIT revenue. For purposes of this analysis, LFO assumes that 25% (~$34 million) of the corpus of such claims are pulled into FY25 that would otherwise not be, with a similar impact occurring in FY26.

New Bonus Depreciation Exemption:

LFO has no basis for an estimate of the impact magnitude for this proposed exemption. LFO notes that it includes activity retroactive to 2023 as eligible for the exemption.