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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 11, 2024

SUBJECT: Preliminary Analysis of Draft Legislation – Individual Income Tax (IIT): 3% Flat Rate, Increased Standard Deduction, Increased Exemption for Certain Income Earned by 65+ Filers, New Business Deductions, Automatic Deduction Increases, Automatic Rate Reduction Triggers

Summary

Expenditures	**2024-25**	**2025-26**	**2026-27**	**2027-28**	**2028-29**
State General Fund	$0	$0	$0	$0	$0
Self-Generated Revenues	+$550,000	$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	Decrease	Decrease	Decrease	Decrease	Decrease
Self-Generated Revenues	Decrease	Decrease	Decrease	Decrease	Decrease
Dedications/Other	Decrease	Decrease	Decrease	Decrease	Decrease
Federal Funds	$0	$0	$0	$0	$0
Local Funds	$0	$0	$0	$0	$0
Annual Total	**-$334,000,000**	**-$1,150,000,000**	**-$1,350,000,000**	**-$1,380,000,000**	**-$1,410,000,000**

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 $550,000. Any expenditure increases would be financed via SGR out of current collections, ultimately reducing SGF revenue mechanically.

Note: This analysis reflects bill serialized as “HLS 25RS-97 DRAFT 10/4/2024 8:41 AM”

Revenue Explanation and Assumptions
The proposal referenced:

- Specifies a tax rate of 3% on all income that is subject to IIT taxation
- Repeals certain personal exemptions and net capital gains deductions
- Increases the $4,500 standard deductions to $12,500, and the $9,000 standard deductions to $25,000; adjusts by CPI-U inflation in all subsequent years
- Doubles the exemption on pension and annuity income for 65+ filers from $6,000 to $12,000, and adjusts by CPI-U inflation in all subsequent years
- Allows full expensing ("Bonus Depreciation") for certain capital investment, retroactive to certain activities beginning in January 2023
- Redefines rate reduction triggers using new methods and definitions, removes sunset
- Is effective on, and applicable to taxable years beginning on or after, January 1, 2025.

Overall fiscal impact of this proposal can be approximated by the impact of the overall change in liabilities implied by the rate, deduction, and exemption changes. LFO estimates a total FY25 impact of -$334 million, FY26 impact of -$1.15 billion, FY27 impact of -$1.35 billion, and FY28 impact of -$1.38 billion.

Effects on FY25 are due to the effective date of the bill and primarily will be driven by changes to IIT withholdings occurring on January 1, 2025. Withholdings typically comprise approximately 70% of overall collections, implying a reduction in cash collections over the latter half of FY25 of approximately $334 million.

Major features of the proposed bill are briefly discussed (each in isolation,) below.

Flat 3% +
Increased Standard Deductions +
Doubled Retirement Income Exemption +
Repealed Personal Exemptions:

Overall IIT liability changes due to the rate reductions, standard deduction and 65+ income exemption increases, and repeal of certain exemptions are modeled using partially-aggregated 2022 tax return data. LFO estimates of the likely impact of these features of the proposed bill are a nearly-full year effect in FY26 of $1.15 billion, and a full-year effect of approximately $1.33 billion in FY27.

Annual CPI-U adjustment for exemptions and standard deductions:

This feature of the proposal will reduce overall IIT revenue further in every subsequent year, relative to the rate and deduction changes estimated in the previous section. In a scenario where CPI-U inflation were 3% in all years in the fiscal note horizon, this component would reduce collections by approximately an additional $26 million in FY27, $52 million in FY28, and so on.

New Bonus Depreciation:

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, and for the purpose of this analysis assumes that this feature of the proposal will approximately offset the repealed deductions in the following section.

Net Capital Gains Deduction & I.R.C. Section 280C Repeal:

These deductions have typically amounted to between $40-$85 million and $1-$20 million, respectively, in recent years. For the purpose of this analysis assumes that this feature of the proposal will approximately offset the repealed deductions in the previous section.

New Trigger Provisions:

This proposal makes significant changes to the existing IIT tax rate trigger language in statute. No additional impact due to these provisions is assumed for the purpose of this analysis, however LFO notes several provisions, some of which will increase the likelihood of future revenue impacts due to thresholds that are more easily-attained. LFO additionally notes that the proposed changes do not reduce the existing complexity in the required calculation method, or the resulting uncertainty.