Legislative Analysis

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INCOME TAX RATE INCREASE

House Bill 5194 (Substitute H-1)
Sponsor: Rep. Steve Tobocman
Committee: Tax Policy (Discharged from Committee)

Complete to 9-18-07

A SUMMARY OF HOUSE BILL 5194 (FLOOR SUBSTITUTE H-1)

The bill would amend the Income Tax Act to:

- Raise the income tax rate from 3.9 percent to 4.6 percent as of October 1, 2007.

- Return the rate to 3.9 percent as of February 29, 2008, if House Joint Resolution X becomes part of the State Constitution. That resolution would raise the sales tax by 1 percent as of March 1, 2008, if approved by state voters. Revenue from the increase would go to the General Fund. (As introduced, the sales tax proposal would go before the voters on January 15, 2008.)

- Establish a process by which the income tax rate could be adjusted based, generally speaking, on the state average unemployment rate and the amount of revenue deposited into or withdrawn from the Countercyclical Budget and Economic Stabilization Fund (BSF or "rainy day fund"). The rate could not go higher than 4.6 percent or lower than 3.9 percent.

- Appropriate $100,000 for the 2006-07 fiscal year to the Department of Treasury for implementation of the bill's provisions. (Any amounts not spent in that fiscal year would carry forward in a work project account and not lapse to the General Fund.)

<u>Rate Adjustment Process.</u> The income tax rate would be adjusted annually in one of two ways, although it could not be lower than 3.9 percent or higher than 4.6 percent. Generally speaking, if the unemployment rate was below a certain level and deposits were being made in the state's "rainy day fund" (or BSF) then the rate would be reduced. If unemployment exceeded a certain level and withdrawals were being made from the BSF, then the rate would be increased. The bill's formula, to be applied by the State Treasurer, is as follows.

(1) If the average unemployment rate is <u>equal to or less than</u> 5.2 percent and revenue was <u>deposited</u> into the BSF in the previous fiscal year, then the rate would be <u>reduced</u> by an amount equal to the quotient of:

The amount deposited in the BSF ÷ the BSF Factor*

*The BSF Factor is (180 billion) X (the consumer price index level for the previous fiscal year ÷ the average consumer price index level for fiscal year 2007.)

(2) If the average unemployment rate is equal to or greater than 5.2 percent and revenue is withdrawn from the BSF, the tax rate would be increased by an amount equal to the quotient of:

The amount withdrawn from the BSF ÷ the BSF factor

The tax rate would be adjusted effective January 1 of the calendar year following each preceding fiscal year. (However, if the state's comprehensive annual financial report is not published before December 31, the calculation would be completed in the month when the report is published, and the rate reduction would be applied retroactively to January 1.)

FISCAL IMPACT:

According to the income tax model (using Tax Year 2005 data), this change would generate about $1.16 billion for FY 2007-08. Since the School Aid Fund is held constant from rate changes, the entire $1.16 billion would affect GF/GP revenues.

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