Fiscal Note

BILL # HB 2421

TITLE: corporate income tax rate; reduction

SPONSOR: Kolodin

STATUS: As Introduced

PREPARED BY: Benjamin Newcomb

Description

HB 2421 would reduce the Corporate Income Tax (CIT) rate from the current rate of 4.9% to 2.0%, beginning in Tax Year (TY) 2026.

Estimated Impact

We estimate that reducing the CIT rate from 4.9% to 2.0% in TY 2026 would reduce General Fund revenue by $(1.19) billion in FY 2027 and $(1.24) billion in FY 2028. This estimate is based on a set of assumptions and caveats that we discuss in more detail in the *Analysis* section below.

Our estimate does not reflect the potential behavioral response of taxpayers to the changes under the proposed new CIT rate. For example, all else being equal, a reduction of corporate income taxes may serve as an incentive for businesses to invest in more capital and hire more labor than they would otherwise. Such "dynamic" effects may result in an increase in economic output, which in turn may generate additional tax revenue for the state General Fund than what our "static" analysis assumes.

Given the lower level of liability, taxpayers may qualify for a lower level of nonrefundable Corporate Income Tax credits. We have assumed that credit usage would decline proportionately to the rate reduction.

Analysis

The revenue impact of HB 2421 as shown in the *Estimated Impact* section is uncertain due to a couple of factors that we have outlined below. For this reason, our estimates must be interpreted with caution.

Factor 1: Volatility of CIT Collections
Our analysis of the proposed rate reduction is based on the projected level of CIT collections through FY 2028 under the January Baseline forecast. CIT is a highly cyclical revenue source and collections can fluctuate significantly over time. From FY 2007 to FY 2010, CIT collections declined (57.9)%, while more than doubling during the period from FY 2021 through FY 2024. If CIT continues its cyclical pattern, our projected fiscal impact of HB 2421 could potentially be notably overstated or understated.

Factor 2: Timing of Revenue Impact from CIT Rate Reductions
The time periods when corporations are required to make their quarterly estimated payments, file their annual tax return, and file their extension return vary widely. This is because a corporation's fiscal year often differs from the calendar year. As a result, a corporation's tax year often includes a 12-month period other than from January to December. For example, a corporation with a fiscal year that runs from May 1, 2026 to April 30, 2027 would not be required to file its 2026 tax return (when the 2.0% rate under the bill would first go into effect) until August 15, 2027, which coincides with the 2028 state fiscal year.

These staggered 12-month periods for corporations means the impact of a rate reduction could fall across multiple fiscal years. For this reason, there is some uncertainty with respect to the exact timing of the bill's revenue impact. For the purpose of this analysis, we have assumed the revenue impact of the rate reduction under the bill would occur entirely in the fiscal year following the tax year it becomes effective. In this particular circumstance, the new tax rate is effective in Tax Year 2026, which means the revenue impact begins in Fiscal Year 2027.

Under the Baseline forecast, we estimate that FY 2027 CIT revenue will be $2.02 billion. Based on the current 4.9% CIT rate, the implied CIT taxable income for FY 2027 is $41.12 billion. Applying the 2.0% rate to this income level, we estimate CIT revenue will be $822.5 million in FY 2027. Compared to $2.02 billion CIT forecast under the Baseline, this results in a General Fund revenue reduction of $(1.19) billion in FY 2027. Using the same method, the Baseline's $2.09 billion CIT revenue forecast for FY 2028 implies $42.71 billion in corporate taxable income. Under the proposed 2.0% rate, this would generate $854.2 million in CIT collections, for a General Fund decrease of $(1.24) billion in FY 2028 relative to the Baseline forecast.

Local Government Impact

Incorporated cities and towns receive 18% of individual and corporate income tax collections from 2 years prior from the Urban Revenue Sharing (URS) Fund established by A.R.S. § 43-206. Since the bill would decrease statewide CIT revenue by $(1.19) billion in FY 2027 and $(1.24) billion in FY 2028, overall annual URS distributions would decrease by $(214.7) million in FY 2029 and $(223.0) million in FY 2030.

2/3/25