DEPARTMENT OF AUDITS AND ACCOUNTS

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Honorable Jay Powell
Chairman, House Ways and Means
133 Capitol
Atlanta, Georgia 30334

SUBJECT: Fiscal Note
House Bill 918 (LC 34 5383-ECS)

Dear Chairman Powell:

The bill would make a number of changes to Georgia's tax code. Part I would amend Georgia law to conform with Internal Revenue Code changes through February 9, 2018, as well as phased-in changes to the state personal and corporate income taxes. The standard deduction amounts for personal income taxes would be doubled effective January 1, 2018. Effective January 1, 2019, the top corporate and personal income tax rates would be lowered to 5.75 percent. The following year, the rates would be lowered to 5.5 percent, subject to passage of a joint resolution. Part III would create a sales and use tax exemption for jet fuel. The other parts of the bill, related to replacement vehicle titles and dates affecting bill provisions, would not have an impact on revenue.

Impact on Revenue – Part I

Georgia State University's Fiscal Research Center (FRC) estimated that Part I of the bill would increase state revenues in fiscal years 2018 through 2020; however, state revenue would decline in the subsequent three years (Table 1). The revenue reductions are largely attributable to changes to personal income tax provisions.

Table 1. Estimated State Revenue Effects of Part 1 of LC 34 5383–ECS

($ *millions*)	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
PIT Phased-In & Conformity Chgs	$28	$252	$24	($520)	($466)	($453)
CIT Phased-In & Conformity Chgs	$45	$13	$369	$53	$126	$198
Total	$73	$265	$393	($467)	($340)	($255)

Summary of Conformity Provisions

During 2017 several federal tax bills with consequences to state revenues were signed into law. These bills include the Tax Cuts and Jobs Act (TCJA) and the Disaster Tax Relief and Airport Extension Act of 2017 (DTRAEA). Although additional bills were also signed at the federal level in 2017, the Georgia Department of Revenue has determined that the provisions contained in these additional bills have no revenue impact to the State. In addition, the Bipartisan Budget Act (BBA) of 2018 was signed into law on February 9, 2018.

The TCJA, the DTRAEA, and the BBA make several changes to the federal income tax code and the subject bill adopts multiple provisions in these acts. Adoption of this legislation aligns the tax code of Georgia with the Internal Revenue Code of 1986 as amended on or before February 9, 2018.

HB 918 adopts all provisions applicable to Georgia included in the DTRAEA and the BBA. All provisions of the TCJA which are applicable to Georgia are being adopted as part of this legislation with the exception of the provisions relating to the following:

- the special 20 percent deduction from qualified business income
- bonus depreciation
- expansion of qualified property under section 179
- modifications of the depreciation rules for new farm machinery and equipment
- modifications related to contributions of capital
- limitations on the deduction of net business income

Table 2 shows the state revenue effects of adopting these provisions for FY 2018-FY 2023. In the case of TCJA provisions affecting state PIT revenues, certain of these are analyzed along with the phased-in changes discussed in the next section of this appendix, and thus are not included in the figures in Table 2. See that section for the list of these provisions.

Table 2. Projected State Revenue Effects of IRC Conformity Provisions

(*$ millions*)	**FY 2018**	**FY 2019**	**FY 2020**	**FY 2021**	**FY 2022**	**FY 2023**
Tax Cuts and Jobs Act	$177.5	$275.5	$192.4	$228.5	$326.6	$423.4
Disaster Tax Relief, and Airport & Airway Extension Act of 2017	($12.3)	($6.6)	$7.6	$3.1	$1.9	$1.1
Bipartisan Budget Act of 2018	($31.9)	($5.6)	$1.2	$0.8	$0.5	$0.3
Total Part I Conformity	$133.3	$263.4	$201.2	$232.4	$329.0	$424.9

Summary of Phased-In Provisions

This appendix section provides estimates of the state revenue effects of specified federal personal income tax changes under the TCJA together with the phased-in modifications to the state personal income tax. In addition, the effects of changes to the state corporate income tax rate to match the top personal rate are estimated separately and also shown in combination with the personal tax changes.

The modeled estimates with regard to the TCJA include most, but not all provisions affecting Georgia taxpayers; provisions included are as follows:

- Itemized deduction changes
  - Reduced floor for medical expense deductions to 7.5 percent of AGI from 10 percent, applicable for tax years 2017-18
  - Limitation on state and local tax (SALT) deductions to no more than $10,000 per year
  - Elimination of casualty and theft loss deduction
  - Elimination of miscellaneous deductions subject to the 2 percent of AGI floor
  - Repeal of Pease limitations on itemized deductions
- Increased federal standard deduction, including induced switching from itemized to standard deductions (taxpayer chooses deduction type that minimizes combined state and federal taxes)
- Repeal of the moving expense deduction (taken before as a reduction in AGI)

Except as noted for the medical expense deduction, all modeled changes are effective for all tax years beginning after December 31, 2017. Because of data limitations, certain changes could not be modeled, including the following, the effects of which are included in the conformity estimates discussed above:

- Reduced limit on the size of new mortgages for which interest may be deducted
- Elimination of deduction for home equity loan interest
- Increased limit for deduction of charitable contributions
- Changes to deductibility or exclusion of alimony payments
- Changes to or clarification of the deductibility of certain gambling-related expenses

Estimates presented herein are derived from a microsimulation model of Georgia taxpayers using an anonymized sample of tax year (TY) 2015 tax return data, consisting of approximately 3.45 million returns representing about 77 percent of all filers in the state for that year. Adjustments are made to the sample results to make them approximately representative of all filers. Modeled changes in aggregate tax liabilities are then applied to baseline PIT revenue projections for the state fiscal years affected, through FY 2023. Baseline projections through FY 2022 were provided by the Office of Planning and Budget; the FY 2023 baseline number is an FRC extension from the trend up to that point.

Modeled HB 918 modifications to the Georgia PIT are as follows:

- Effective January 1, 2018, double Georgia standard deduction amounts from $2,300 to $4,600 for Single and Head of Household filers, from $3,000 to $6,000 for Married Joint filers, and from $1,500 to $3,000 for Married Separate filers.
- Effective January 1, 2019, cut top bracket marginal tax rate from 6.0 percent to 5.75 percent.
- Effective January 1, 2020, cut top bracket marginal tax rate from 5.75 percent to 5.50 percent.

CIT revenue effects included below reflect the following:

- Effective for tax years beginning on or after January 1, 2019, cut state CIT rate from 6.0 percent to 5.75 percent.
- Effective for tax years beginning on or after January 1, 2020, cut state CIT rate from 5.75 percent to 5.50 percent.

The third of the phased-in PIT changes and the second of the CIT, in both cases a reduction in rate to 5.50 percent, are contingent on the passage and signing by the governor on or after January 13, 2020, of a joint resolution ratifying the effectiveness of these provisions. For this reason, estimated revenue effects absent effectiveness of these final rate reductions are also provided (see lines in Table A3 labeled "+ 5.75% Top Rate").

Finally, rate cuts on both the PIT and the CIT would have the effect of reducing the gains or losses from other federal tax changes to which the state is anticipated to conform, so these effects are also presented below in summary form. Note that the "Other PIT Conformity" effects included in this final adjustment are only those that could not be included in the microsimulation modeling of federal changes as discussed above. The effects of rate cuts on the magnitude of gains from the business provisions, as well as on baseline CIT revenues, also reflect a degree of shifting (delaying) of income recognition by businesses from TY 2018-19 to TY 2019-20 to take advantage of the scheduled rate reductions.

State Revenue Effects of Phased-In and Conformity Provisions
Allocation of PIT tax year effects on tax liabilities to fiscal years assume that, for the early years, higher state tax liabilities for some filers will lead to those filers delaying filing or obtaining extensions on the time to file their returns. In addition, where changes in tax liabilities would normally be assumed to be reflected in changes in withholding and estimated tax payments, the ability of taxpayers to make adjustments to those payments is assumed to be limited at least for TY 2018. These factors considered, TY effects are spread to FYs as shown in Table 3. By TY 2021, the FY effects of TY tax liability changes are assumed to be stabilized, with the spread across fiscal years largely reflecting the timing of withholding and estimated tax payments.

Table 4 below provides baseline revenue projections as well as proforma projections reflecting the federal changes and the phased-in changes listed above. Intermediate step estimates are also provided, as if the given set of changes were all effective January 1, 2018. Each set of estimates reflects the combined effects of i) the federal changes and ii) the particular scenario. The final two lines of the table reflect the combined effects of the federal changes and the phased-in changes, one with all three steps phased in and the other with only the first two steps.

Table 3. Timing Assumptions for FY Impact of TY Changes to PIT

Tax Year of Change in Liability:	Fiscal Year Impacted: FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
TY 2017*	100%					
TY 2018	17%	50%	33%			
TY 2019		38%	50%	13%		
TY 2020			42%	54%	4%	
TY 2021				46%	54%	
TY 2022					46%	54%
TY 2023						46%

* Retroactive change in medical expense deduction only.

Table 4. Estimated State Revenue Effects of Federal & Phased-In State PIT/CIT Changes

(*$ millions*)	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2018-23
PIT:	|---------------------OPB Baseline Forecast				----------------|	FRC Proj	
Baseline PIT Revenue	$11,416	$12,026	$12,603	$13,195	$13,802	$14,423	$77,466
% Change in Rev	3.99%	5.34%	4.80%	4.70%	4.60%	4.50%	
Modeled TCJA Chgs	**$118**	**$760**	**$1,147**	**$1,089**	**$1,055**	**$1,058**	**$5,226**
3-Step Changes:							
2x Standard Deduction (*effective CY 2018*)	$56	$416	$632	$579	$583	$585	$2,851
+ 5.75% Top Rate (*effective CY 2019*)	$56	$238	$176	$16	$16	$16	$518
+ 5.5% Top Rate (*effective CY 2020*)	$56	$238	($30)	($587)	($547)	($549)	($1,418)
Other PIT Conformity Provision Chgs	($28)	$14	$54	$67	$81	$96	$284
3-Step Chgs + PIT Conformity Chgs	**$28**	**$252**	**$24**	**($520)**	**($466)**	**($453)**	**($1,134)**
CIT:	|---------------------OPB Baseline Forecast				----------------|	FRC Proj	
Baseline CIT Revenue	$999	$1,068	$1,089	$1,114	$1,131	$1,148	$6,550
% Change in Rev	2.78%	6.92%	2.00%	2.30%	1.50%	1.50%	
Business Conformity Effects	$161	$249	$144	$159	$240	$320	$1,274
Adjusted Baseline Rev	$1,160	$1,317	$1,233	$1,273	$1,371	$1,468	$7,823
2-Step Changes*:							
5.75% CIT Rate (*effective CY 2019*)	$45	$335	$93	$106	$183	$259	$1,021
+ 5.50% CIT Rate (*effective CY 2020*)	**$45**	**$13**	**$369**	**$53**	**$126**	**$198**	**$804**
PIT + CIT Effects	**$73**	**$265**	**$393**	**($467)**	**($340)**	**($255)**	**($330)**

* Includes the effects of income shifting by businesses.

Impact on Revenue – Part III

Under the proposed bill, part III of the bill would change the tax treatment of jet fuel within Georgia. Jet fuel would be exempt from all local sales taxes except for those joint county/municipal LOSTs and MARTA taxes in affect prior to December 30, 1987, which would continue to apply at no more than the rate then in effect.

Under current law, jet fuel is subject to an estimated local sales tax rate of 2.1 percent. This is the average of local sales tax rates weighted by the estimated amount of jet fuel sold in each county. As such, this average rate is heavily influenced by the current two percent local sales tax rate for jet fuels in Clayton County. The grandfathered local taxes apply in counties where relatively small amounts of jet fuel are sold, thus the effective local tax rate for jet fuel would decrease to 0.01 percent statewide, on average.

The wide range of jet fuel prices experienced over recent years indicates there are a wide range of revenue impacts that are feasible under this proposed legislation. Georgia Department of Revenue (DOR) began in July 2015 requiring separate reporting of jet fuel sales and has provided data on sales tax collections from jet fuel for FY 2016, FY 2017 and the first six months of FY 2018. A key challenge in estimating the impact of this change over time is the extreme volatility of jet fuel prices. In July 2015 when DOR began collecting this revenue data, the price of spot jet fuel averaged $1.56 per gallon. By January of 2016, the price had fallen to $0.95 per gallon, a drop of 40% in a six-month period. This volatility is even more extreme in light of jet fuel prices ranging from $2.50 per gallon to more than $3.00 per gallon for 2011 through 2014.

Table 5 contains recent sales tax collections from jet fuel since DOR began requiring separate reporting. Note that this collections data through FY 2017 corresponds to a period of low jet fuel prices. In recent months jet fuel prices have fluctuated. In July 2017, jet fuel prices averaged $1.41 per gallon. By December 2017, the average price had increased to $1.81, a 40% increase. The FY 2019 budget estimates state revenue for jet fuel at $35.2M.

Table 5. Sales Tax Collections from Jet Fuel

($ *millions*)	FY 2016	FY 2017	FY 2018*
State	$31.4	$34.9	$19.4
Local	$17.4	$20.8	$11.9

*FY 2018 reflects collections through December 31, 2017

Commodities such as oil and its refined products can experience highly volatile price changes that extend for multiple years. Changes in production capacity, demand, and geo-political conditions are just a few factors that contribute to this volatility. It is possible to devise feasible scenarios in which jet fuel prices are much lower than those assumed in these two pricing scenarios or are much higher.

Impact on State Expenditures
Given the recent revisions to the bill, the Department of Revenue (DOR) has not yet produced a cost estimate of complying with the changes.

Sincerely,

Greg S. Griffin

Greg S. Griffin
State Auditor

Teresa A. MacCartney

Teresa A. MacCartney, Director
Office of Planning and Budget

GSG/TAM