DEPARTMENT OF AUDITS AND ACCOUNTS

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March 9, 2020

Honorable Brett Harrell
Chairman, House Ways and Means
133 State Capitol
Atlanta, Georgia 30334

SUBJECT: Fiscal Note
House Bill 949 (LC 43 1624S)

Dear Chairman Harrell:

The bill would result in several changes to the state's income tax code. The bill would:

- Incorporate the 2019 changes to the federal income tax code into state law;
- Eliminate the itemized deduction for Georgia income taxes paid and replace the current graduated tax-rate structure with a flat personal income tax rate of 5.375 percent;
- Repeal the existing low-income tax credit and replace it with a new credit that phases out at higher income levels;
- Increase the amount of credit earned for adoption of a foster child from $2,000 to $6,000 per year for the first five years after adoption or until the child turns age 18, if earlier

Several of the federal conformity provisions would be effective for tax years beginning on or after January 1, 2020, but other provisions are effective retroactively to the 2018 tax year or to the date of enactment of the particular bill. The increased foster adoption credit would apply to eligible adoptions occurring on or after January 1, 2020. All other provisions of the bill would be effective for tax years beginning on or after January 1, 2021.

Impact on Revenue

Georgia State University's Fiscal Research Center (FRC) estimated that the bill would reduce revenue by $76.3 million in FY 2020. The loss would be $248.6 million in FY 2023, the first year of the income tax reduction's full effect, and increase in subsequent years. Details of the analysis are included in the appendix.

Table 1. Estimated State Revenue Effects of HB 949

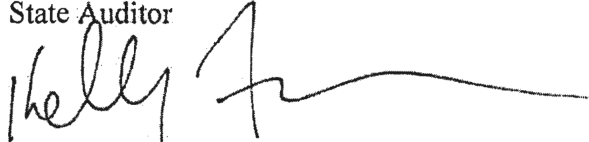
($ *millions*)	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025
Federal Conformity	($76.3)	($48.6)	($1.4)	$2.7	($0.2)	($1.5)
Foster-Adoption Credit	-	($0.3)	($0.6)	($0.9)	($1.1)	($1.4)
Flat PIT Rate & Other	-	($97.4)	($221.8)	($250.4)	($259.2)	($268.2)
Total	($76.3)	($146.3)	($223.8)	($248.6)	($260.5)	($271.1)

Impact on State Expenditures

The Department of Revenue (DOR) did not anticipate the need for new staff; however, it noted that changes required by the bill would require approximately $300,000 in existing staff time. Information technology changes would require two months of work for at least six staff members, while the Taxpayer Services Division would spend funds on the creation of new tax booklets and forms and the training of more than 50 employees.

Sincerely,

Greg S. Griffin
State Auditor



Kelly Farr, Director
Office of Planning and Budget

GSG/KF/mt

Analysis by the Fiscal Research Center

Federal Conformity
The estimates provided in Table 1 are based on the federal revenue estimate of the same provisions produced by the Joint Committee on Taxation (JCT). Due to the number of provisions included in the federal legislation, we apply the same general approach to all the estimate. To derive the state estimate, we adjust the federal estimate to represent a total tax base of income and adjust that figure to reflect a calendar year value. We then share down the calendar year base amount to reflect Georgia's share of this activity. We apply a state tax rate of 5.75 percent for tax years beginning before January 1, 2021, and for later tax years, we adjust the rates to reflect the proposed change in this bill to a flat 5.375 percent rate for personal income taxes. Thus, for TY 2021 and later, we use 5.375 percent for provisions affecting only personal income taxes and a blended rate of 5.52 percent for business provisions to produce the CY revenue estimate and adjust the estimate to reflect state fiscal years.

Major provisions included in the estimate are:
Exclusion from gross income of discharge of qualified principal residence indebtedness
The provision provides a maximum exclusion from gross income of $2,000,000 for a discharge of qualified principal residence indebtedness. Generally, indebtedness must be the result of acquisition, construction, or substantial improvement of primary residence. The provision also modifies the exclusion to apply to qualified principal residence indebtedness that is discharged pursuant to a binding written agreement entered into before January 1, 2021. The Disaster Act extends this exclusion for 3 years for discharges of indebtedness before Jan. 1, 2021 (2018 - 2020). **Code Sec. 108(a)(1)(E)**

Treatment of mortgage insurance premiums as qualified residence interest
The provision provides for the treatment of qualified mortgage insurance premiums as interest for purposes of the mortgage interest deduction. This deduction phases out for taxpayers with adjusted gross income (AGI) over $100,000 ($50,000 if married filing separately). The Disaster Act extends this treatment through 2020 for amounts paid or incurred after Dec. 31, 2017 (2018 - 2020). **Code Sec. 163(h)(3)(E)(iv)(I)**

Reduction in medical expense deduction floor
Before 2017, individuals could claim an itemized deduction for unreimbursed medical expenses to the extent that such expenses exceeded 10 percent of AGI. The provision extends the lower threshold of 7.5 percent, originally enacted for 2017 and 2018. The Disaster Act extends this threshold of 7.5% for tax years beginning after Dec. 31, 2018 and before Jan. 1, 2021 (2019 - 2020). **Code Sec. 213(f)**

Deduction of qualified tuition and related expenses
The provision provides an above-the-line deduction for qualified tuition and related expenses for higher education. The deduction is capped at $4,000 for an individual whose AGI does not exceed $65,000 ($130,000 for joint filers) or $2,000 for an individual whose AGI does not exceed $80,000 ($160,000 for joint filers). The Disaster Act extends this deduction through 2020 (2018 - 2020). **Code Sec. 222(e)**

Extension of expensing rules for certain productions
The provision provides a deduction for qualified film, television, and theatrical productions of up to $15 million of the aggregate cost ($20 million for certain areas) of a qualifying film, television, or theatrical production in the year the expenditure was incurred. The Disaster Act extends this deduction through 2020, for productions commencing after Dec. 31, 2017 (2018 - 2020). **Code Sec. 181(g)**

Other disaster-related tax relief provisions
(a) Temporary suspension of limitations on charitable contributions. The provision temporarily suspends limitations on the deduction for charitable contributions associated with qualified disaster relief. (b) Special rules for qualified disaster-related personal casualty losses. With respect to uncompensated losses arising in the disaster area, the provision eliminates the current law requirements that personal casualty losses must exceed 10 percent of Adjusted Gross Income to qualify for deduction. **(2018- first part of 2020). Sec. 304 of the Disaster Act**

Repeal of increase in unrelated business taxable income for certain fringe benefit expenses
P.L. 115-97 required the unrelated business taxation income (UBTI) of tax-exempt organizations to be increased by expenses related to qualified transportation fringe benefits (the so-called "church parking tax"). This section repeals that requirement. This repeal applies to amounts paid or incurred after December 31, 2017 (2018 and forward). **Code Sec. 512(a)(7)**

The "Setting Every Community Up for Retirement Enhancement" Act (the SECURE Act) provisions that affect Georgia
The Act significantly modifies many requirements for employer-provided retirement plans, individual retirement accounts (IRAs), and other tax-favored savings accounts. While some of the modifications go into effect retroactively or upon enactment (December 20, 2019), many of them carry future effective dates.

Foster-Adoption Credit
Under current law the amount of the credit is $2,000 per qualified adoption per year, beginning the year in which the adoption becomes final and ending in the year that the adopted child reaches the age of 18. For all adoptions occurring before the effective date of this provision, January 1, 2020, current law would continue to apply. For foster adoptions occurring on or after January 1, 2020, the proposed bill would increase the credit earned to $6,000 per year for the first five years after the adoption becomes final. The total amount of the tax credit allowed per year shall not exceed the taxpayer's income tax liability, and for any adoptions occurring on or after the effective date, no carryforwards of unutilized tax credits are permitted. Again, the bill would be effective for any eligible adoption occurring on or after January 1, 2020, and would not impact adoptions occurring before that date, with regard to either amount or carryforwards.

The estimates rely on data from the Georgia Department of Revenue (DOR) on the usage of the foster care adoption credit from TY 2009 through 2017, and in particular on detail available for TY 2017 as to carryforward balance changes. The report "Trends in U.S. Adoptions: 2008-2018", from the federal Department of Health and Human Services (HHS), provided data on foster adoption trends and the age distribution of adoptees.

The DOR data indicated a net increase of 408 in the number of credits earned (i.e. credit-eligible adoptees) in TY 2017 over the prior year, slightly faster growth than the 380 net increase in TY 2016. The HHS data indicated that 1,401 children were adopted out of foster care in Georgia during FY 2017. Though the data do not allow estimation of gross new credits earned (before attrition of aged-out adoptees and those who moved out of the state), the apparent discrepancy suggests that significant numbers of foster care adoptions occur in Georgia without the parents subsequently claiming the tax credit. If this apparent discrepancy is correct and these taxpayers respond to the increased credit amount by participating at greater rates, then the realized fiscal impact could be greater than that estimated in this analysis.

- The detailed DOR data for TY 2017 on the utilization of the adoption foster care credit indicate that 59.9 percent of the credits earned in the year were utilized in the same year and 6.9 percent of existing carry forwards are utilized. The current-law baseline assumes the same shares of current period and carried forward credits are utilized each year through TY 2025.
- Using HHS data on the age breakdowns of those being adopted out of foster care were used to estimate that approximately 54 percent of the credits earned in TY 2017 where those within the first five years after adoption. This share is estimated to decrease to 42.2 percent by TY 2024 as a result of the relative numbers of new adoptions and the numbers aging out.
- HHS data indicate that adoptions out of foster care in Georgia grew at .56 percent per year between FY 2009 and FY 2018. The estimates assume this growth rate in the number of new adoptions continues unchanged, resulting in growth of the pool of credit-generating adoptees averaging 6.4 percent annually from TY 2017 through TY 2024.

For many taxpayers earning the current foster child adoption credit, the annual credit exceeds their tax liability and generates a carryforward. Since many children are adopted out of foster care very young, many taxpayers accumulate growing carryforward balances year after year. At the aggregate level, we observe this as rapidly growing carryforward balances that greatly outpace the growth of the credits utilized. These taxpayers will therefore continue to utilize these carry forward amounts against future taxes after their foster children turn 18. However, credits generated for 2020 and later adoptions will not generate carryforwards under the proposed bill.

Using DOR data to simulate the credit increase, as if in effect in 2017, it is estimated that the share of the $4,000 increase in credits earned that can be utilized in the same year to offset tax liability is 14.9 percent, with the remainder adding to the carryforward balance. The reason for this is simply that for most taxpayers currently claiming the credit, the existing credit amount already fully offsets their tax liability, thus the increased credit amount would simply increase their carryforward balances. As under the current law projections, 6.9 percent of the additional carryforward balance at the end of each year are assumed to be utilized in the following year.

Table 2 presents projections of the numbers of credits-eligible adoptees, credits utilized, and accumulated carry forward amounts under current law and the proposed bill.

Table 2. Tax Year Credits Utilized and Accumulated Carry Forward Balances

(*$ millions*)	TY 2020	TY 2021	TY 2022	TY 2023	TY 2024
Current Law Baseline					
Utilized credits	$7.0	$7.6	$8.2	$8.7	$9.1
YE carry-forward bal.	$17.6	$20.7	$23.8	$26.8	$29.8
Proposed Law					
Utilized credits	$7.3	$8.2	$9.0	$9.8	$10.4
YE carry-forward bal.	$17.5	$19.9	$21.9	$23.6	$24.8

Flat Tax Rate and Other Personal Income Tax Changes

The remainder of the revenue-impacting provisions of the bill were estimated using a microsimulation model and an anonymized sample of tax year (TY) 2017 tax return data, consisting of approximately 3.56 million returns representing about 79 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 personal income tax (PIT) revenue projections for the state fiscal years affected, through FY 2025. Baseline projections were provided by the Office of Planning and Budget (OPB).

The model first accounts for tax changes resulting from the federal Tax Cut and Jobs Act (TCJA) and Georgia HB 918, simulating tax liabilities under current law. TCJA changes modeled include the following:

- Itemized deduction changes
  - 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)

Because of data limitations, certain changes could not be modeled, including the following:

- 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

Modeled HB 918 modifications to the Georgia PIT (except with respect to timing of the second rate cut) are as follows:

- Georgia standard deduction amounts of $4,600 for Single and Head of Household filers, $6,000 for Married Joint filers, and $3,000 for Married Separate filers
- Top marginal tax rate of 5.75 percent

Modeled modifications to the PIT under this bill are as follows:

- Replace the graduated PIT rate structure with a single, flat rate of 5.375 percent.
- Create a nonrefundable personal income tax credit equal to 0.375 percent of the amount by which the taxpayer's federal adjusted gross income (FAGI) is below certain maximum amounts based on filing status, plus $7.50 ($3.75 if married filing separately) times the number of dependents claimed on the filer's return. FAGI limits by filing status are as follows:
    - Single: $58,750
    - Married filing separately: $47,000
    - Married filing joint or head of household: $94,000
- Eliminate the state low income credit by repealing Chapter 7A of Title 48 in its entirety.
- Eliminate the itemized deduction for Georgia income taxes paid, to the extent remaining after the limitations in the Tax Cut and Jobs Act (TCJA).

Tax liabilities are recalculated with the new itemized or standard deduction choices, and the sample results are gross-up to represent the estimated reduction in tax liabilities for all filers as a percent of baseline liabilities. The estimated reductions are applied to the OPB baseline forecast to calculate the projected state revenue impacts, with timing adjustments to reflect the January 1, 2021 effective date of the proposed changes and to adjust to fiscal years.

Table 3 below provides details of the timing adjustments, with tax year liability changes split across the fiscal years in which the impacts of the bill on state collections would be realized. Table 4 provides baseline revenue projections as well as proforma projections reflecting the proposed changes.

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

Tax Year of Change in Liability:	Fiscal Year Impacted:					
	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025
TY 2021		42%	50%	8%		
TY 2022			42%	50%	8%	
TY 2023				42%	50%	8%
TY 2024					42%	50%
TY 2025						42%

Table 4. Baseline and Proforma Projected State PIT Revenues

($ millions)	**FY 2020**	**FY 2021**	**FY 2022**	**FY 2023**	**FY 2024**	**FY 2025**
Current Law Baseline Revenue	$12,299	$12,653	$13,096	$13,554	$14,029	$14,520
% Change over prior year	1.0%	2.9%	3.5%	3.5%	3.5%	3.5%
Proforma PIT Revenues	$12,299	$12,556	$12,874	$13,304	$13,770	$14,251
% Change from baseline	0%	-0.8%	-1.8%	-1.9%	-1.9%	-1.9%
PIT Effect of Modelled Changes	-	($97.4)	($221.8)	($250.4)	($259.2)	($268.2)