

Fiscal Note

BILL # SB 1213

TITLE: income tax; credit; labor costs

SPONSOR: Rogers

STATUS: As Introduced

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Description

The bill, as introduced, would create an individual and corporate income tax credit employers could claim for increased labor costs stemming from a local minimum wage that is set above the state minimum wage. The credit would be equal to 5% of the difference between a business's actual wage base (i.e., total wages paid) and what its wage base would have been if all its employees were paid the state minimum wage. The credit is nonrefundable.

To partially reimburse the state for any General Fund revenue losses, cities and towns with higher local minimum wages would have up to \$5 million of their Urban Revenue Sharing (URS) distributions withheld from them equal to the amount of this credit claimed during the previous taxable year with certain exceptions. The bill would become effective beginning in Tax Year (TY) 2025.

Estimated Impact

We estimate that the bill would decrease annual income tax revenue by \$(207.8) million, beginning in FY 2026. The state would recoup \$10 million of this amount from withheld URS distributions for a net decrease in General Fund revenue of \$(197.8) million in FY 2026. These estimates are based on the local minimum wage laws currently in place in the cities of Flagstaff and Tucson.

The bill provides that the Treasurer will withhold URS distributions in the year after the taxable year in which the credit for increased labor costs is claimed. As a result, TY 2025 tax credit claims will occur in FY 2026 when the employers are filing their taxes in the spring of 2026. The bill intends that the state be "paid" with lower URS distributions in Calendar 2026. The tax credits' losses, however, will not be known until after June 2025 due to the timing of tax filing. As a result, the tax loss will occur in FY 2026, but the URS withholding would likely not happen until FY 2027 (at some point after July 2026).

Analysis

Flagstaff Impact- The hourly minimum wage in Flagstaff is \$17.40 in TY 2024, \$3.05 higher than the state minimum wage of \$14.35. The minimum wages for the state and for Flagstaff are adjusted annually based on the percentage change of the U.S. Consumer Price Index (CPI). Based on the most recent CPI forecast by S&P Global, an international forecasting firm, we estimate that the state minimum wage will increase to \$14.75, and Flagstaff's local minimum wage will increase to \$17.87 in TY 2025.

According to the U.S. Bureau of Labor Statistics (BLS), the total number of private-sector employees in the Flagstaff metropolitan area is 50,200. Based on the population of the city in Flagstaff relative to its entire metropolitan area, we estimate that there are 37,900 total employees in the city itself. We then adjusted this number downward by 8.1% to exclude non-profit workers. The 8.1% factor is the statewide percentage of Arizona employment in non-profit jobs.

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(While non-profits would technically be included under the proposed legislation, those entities would not receive the tax credit as they are tax exempt). We further adjusted this total to remove public sector workers, which we estimate to be about 27% of the total workforce. After these adjustments, we estimate that there are 24,500 credit eligible employees in Flagstaff.

In 2023, workers in Flagstaff worked an average of 31.6 hours per week (equivalent to 1,643 hours per year) at an average hourly rate of \$25.09, which equates to an average yearly wage of \$41,228, according to the BLS. Multiplying the number of private-sector employees by the average annual wage, we estimate that the total TY 2025 wage base is \$1.01 billion [=24,500 workers x \$41,228 annual wage]. If these employees had been paid the state minimum wage, the total wage base would have been \$593.7 million [=24,500 workers x 1,643 hours x \$14.75 TY 2025 state minimum wage]. This means that the TY 2025 increased labor cost under the bill would be \$417.1 million [= \$1.01 billion - \$593.7 million]. Businesses in Flagstaff would be eligible to claim 5% of the increased labor costs in credits for TY 2025, or approximately \$20.8 million, which would be claimed when their TY 2025 tax returns are filed in the spring of 2026.

Using data from the U.S. Bureau of Economic Analysis (BEA) on proprietors' income and state Gross Domestic Product (GDP), we estimate the combined TY 2025 corporate and individual income tax liability of Flagstaff businesses to be \$43.6 million. Since this amount is higher than the estimated \$20.8 million in earned credits under the bill, Flagstaff employers would be able to claim the full value of the credit in FY 2026.

Under current law, we estimate the Flagstaff URS distribution to be \$14.7 million in FY 2026. Under the bill, the State Treasurer would withhold \$5 million of this amount from Flagstaff.

The combined impact of the TY 2025 credit cost of \$20.8 million and the \$5 million in URS distributions withheld from Flagstaff is a net General Fund revenue loss of \$(15.8) million in FY 2026.

Tucson Impact- The Tucson hourly minimum wage will increase to \$15.00 on January 1, 2025, and will be adjusted for inflation annually thereafter. Based on BLS data, we estimate there will be 151,900 qualifying Tucson private-sector employees after adjusting for non-profit and public sector workers. We estimate these employees earn an average annual wage of \$50,531. The average yearly hours worked in Tucson is 1,758, so we project that the wage base for Tucson employers under the bill to be \$7.68 billion [= 151,900 workers x \$50,531 average annual wage]. If these employees had earned the state minimum wage, the total wage base would have been \$3.94 billion [=151,900 workers x 1,758 hours x \$14.75 TY 2025 state minimum wage]. This means that the TY 2025 increased labor cost under the bill would be \$3.74 billion [= \$7.68 billion - \$3.94 billion]. Tucson employers would be eligible to claim 5% of the increased labor costs in credits for TY 2025, or approximately \$187.0 million, which would be claimed when their TY 2025 tax returns are filed in the spring of TY 2026.

We estimate Tucson employers have a total of \$257.8 million in total corporate and individual income tax liability. Since this amount is higher than the estimated \$187.0 million in earned credits under the bill, Tucson employers would be able to claim the full value of the credit in FY 2026.

Under current law, we estimate the Tucson URS distribution to be \$105.7 million in FY 2026. Under the bill, the State Treasurer would withhold \$5 million of this amount from Tucson.

The net impact of the TY 2025 credit cost of \$187.0 million and the \$5 million in withheld URS distributions from Tucson is a net General Fund revenue loss of \$(182.0) million in FY 2026. Combining the Tucson impact with the Flagstaff loss of \$(15.8) million, the statewide FY 2026 loss is \$(197.8) million.

Local Government Impact

Incorporated cities and towns receive 18% of individual and corporate income tax collections from 2 years prior from the URS Fund established by A.R.S. § 43-206. Since the bill would decrease statewide income tax revenue by \$(207.9) million starting in FY 2026, overall URS distributions would be reduced by \$(37.4) each year, beginning in FY 2028.