

AZ Budget Priorities: Geographical Impact of Lowering Tax Rates for High Income Earners v. Investing in At-Risk Children

A centerpiece of Governor Ducey and Arizona's Republican legislative leadership's "flat" tax plan is an effort to move from a progressive marginal rate system to one that eliminates the higher tax rates and replaces it with one rate that is about the same as what lower income earners currently face. The cost when fully implemented is \$1.5 billion annually.¹

By contrast, the Grand Canyon Institute has proposed an \$800 million education opportunity weight to provide targeted funding focused on at-risk children. Six hundred thousand at-risk youth attending publicly-funded district and charter schools would benefit.

These two policies have vastly different focuses on beneficiaries.

The proposed tax cut would have the following impact:

- 350,000 Arizona households with incomes above \$150,000 will be the largest beneficiaries.
- 1.5 million households (four times as many) would see little or modest changes in their state income tax.

Table 1 shows a married couple with income of \$40,000 taking the standard deduction will have their taxes reduced by \$14. Income of \$80,000 would decrease a married couple's taxes by a modest \$55. While a more affluent couple with \$160,000 in income saves nearly \$1,000, and a couple with \$320,000 would see their taxes reduced by

¹ Contained in HB2900 and SB1828 omnibus taxation, [Bill Status Inquiry \(azleg.gov\)](http://azleg.gov). This analysis does not look at other provisions in the bill.

\$3,625. Notably, none of these couples are subject to the Prop. 208 surcharge of 3.5% which kicks in on taxable income above \$500,000.

Table 1

Adjusted Gross Income (married)	Standard Deduction (for illustration)	Taxable Income	Current State Income Tax	Income Tax at 2.5%	Difference in Tax Paid
\$40,000	\$24,800	\$15,200	\$394	\$380	\$14
\$80,000	\$24,800	\$55,200	\$1,435	\$1,380	\$55
\$160,000	\$24,800	\$135,200	\$4,323	\$3,380	\$943
\$320,000	\$24,800	\$295,200	\$10,995	\$7,380	\$3,615

Geographic Impact of the Proposed Tax Cut v. Education Funding for At-Risk Youth

These two groups are not equally distributed across Arizona.

Eliminating Higher Marginal Tax Rates

This policy mostly benefits:

- Affluent communities
- Maricopa County compared to rural Arizona and Tucson

Investments Focused on At Risk Children

This policy mostly benefits:

- Middle and lower income communities
- Rural Arizona and Tucson

This analysis uses data from Census Bureau's 2010 decennial census updated annually through the American Community Survey to provide estimates for geographical impact of eliminating higher marginal tax rates and investing in at-risk children.

GCI used the Arizona Department of Revenue's 2017 tax return analysis (the most recent available) combined with household income data from the census to estimate the portion of people currently in the 2.59% marginal income tax bracket. GCI estimates that households with \$35,000 or less in income fall in this tax bracket. GCI estimates these households will see their taxes reduced by \$15 or less as the tax plan would lower their marginal tax rate to 2.5%, 0.09% less. This is an approximate cut off. As shown in Table 1 some households above \$35,000 will also have income tax reductions of less than \$15 and there may also be some cases where it slightly exceeds \$15. This cut point is likely conservative, meaning more filers will be in the \$15 or less group, but due to data constraints it's used.

By contrast, GCI, estimates that households with incomes exceeding \$150,000 a year will save more than \$1,000 due to the change (see Appendix 2 for methodological details). Generally these taxpayers have either a 4.17% top marginal tax rate or a 4.5% top marginal tax rate which will be reduced to 2.5%. This cut off is also approximate, as Table 1 illustrates a married couple with an income of \$160,000 whose tax reduction is just under \$1,000. If they had children or had larger deductions, their liability would be less. Consequently, this cut point likely overstates the number of filers saving more than \$1,000, but due to data constraints it's used.

GCI used census data from the American Community Survey to identify the number of at-risk youth around Arizona. The American Community Survey identifies the number of children in households that received help such as through the Supplemental Nutrition Assistance Program (SNAP). GCI then multiplies the number of children receiving help by 1.6, based on the assumption that 60% more students beyond those receiving benefits are likely at risk. This methodology mirrors the one used by the National School Lunch Program's Community Eligibility Program's meal reimbursement system, which is used to provide meals to schools with the highest poverty rates.

GCI completed analyses for all 30 legislative districts and counties as well as select cities and towns to illustrate how differently the elimination of higher marginal tax rates impact communities compared to focused investments in at-risk children.

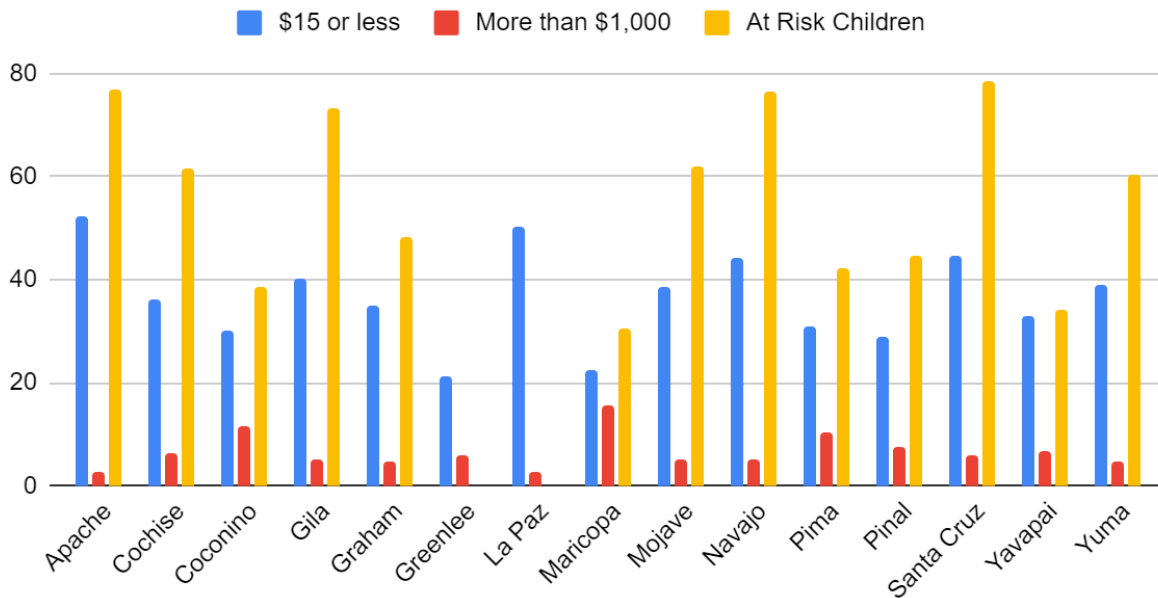
Figure 1 below by county shows clearly how much better investments in at-risk children targets economic development in rural areas compared to eliminating higher marginal tax rates, which provides very little positive impact in rural areas.

Rural Counties — Tax Reduction v. At-Risk Youth Education Funding

In rural counties typically only 5% or 6% of households will have their taxes reduced by more than \$1,000 whereas well over half the children are identified as at risk. Consequently, rural areas will receive very little direct economic impact from the proposed tax reductions whereas investments in their public district and charter schools will provide more clear focused benefits.

Figure 1

Tax Impact of Eliminating Higher Marginal Rates Proposal v. At-Risk Children by County (in percent)



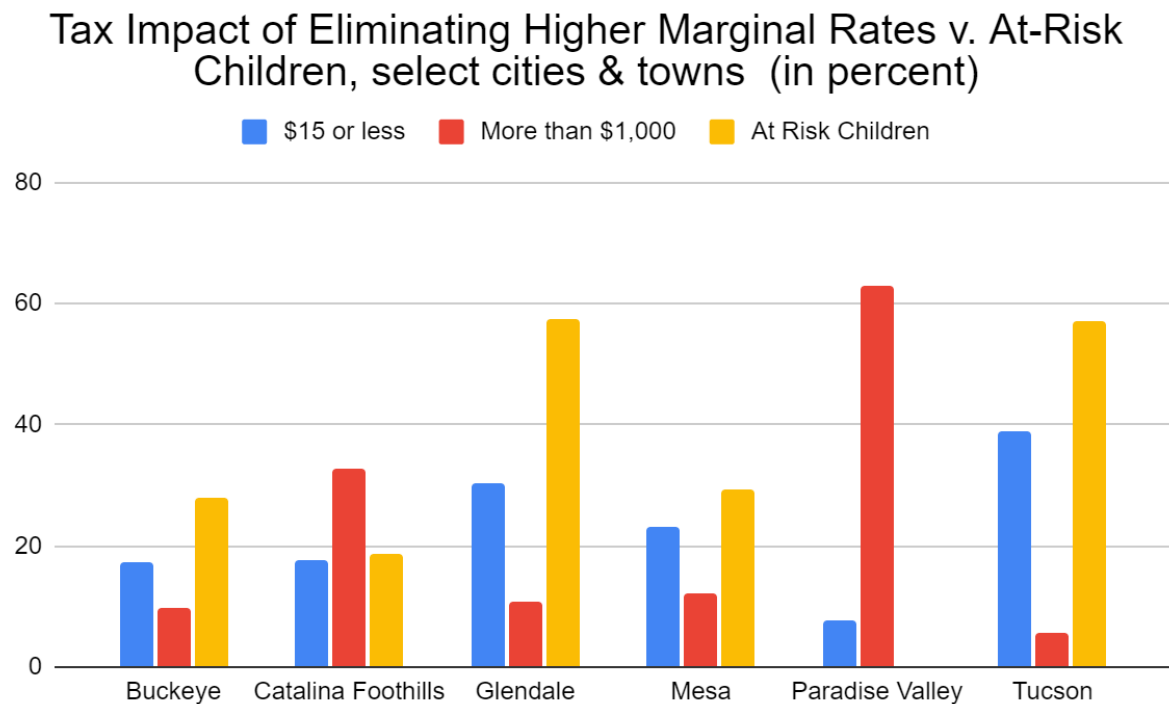
Cities & Towns — Tax Reduction v. At-Risk Youth Education Funding

A similar pattern is found when looking at select cities and towns.

- Paradise Valley — A significant 60% of households are projected to save more than \$1,000 and less than 10% will receive \$15 or less in reduced taxes.
- Glendale — 30% of households are projected to see their taxes reduced by \$15 or less, while only 10% of households will save more than \$1,000.

The number of at-risk children correlates with the number of lower income taxpayers. In areas with more households receiving \$15 or less such as Glendale and Tucson, more than half the children are identified as at risk.

Figure 2



Legislative Districts — Tax Reduction v. At-Risk Youth Education Funding

The pattern can also be seen in Arizona’s legislative districts (LD). In Figure 3, select LDs are illustrated which show comparatively the minimal benefit rural LDs get by eliminating the higher tax brackets, and while Maricopa County does better, geographic location within the county makes a difference. LD 23 in the affluent areas of Fountain Hills and North Scottsdale fares well but the lower and middle income area of LD 21

covering Peoria and El Mirage gets far less relative benefit. Figure 4 includes maps of all legislative districts with the impacts of removing higher income tax brackets as well as the portion of at-risk children. All 30 legislative districts are detailed in Appendix 1 along with all the data for the counties. The tax methodology follows in Appendix 2.

Figure 3

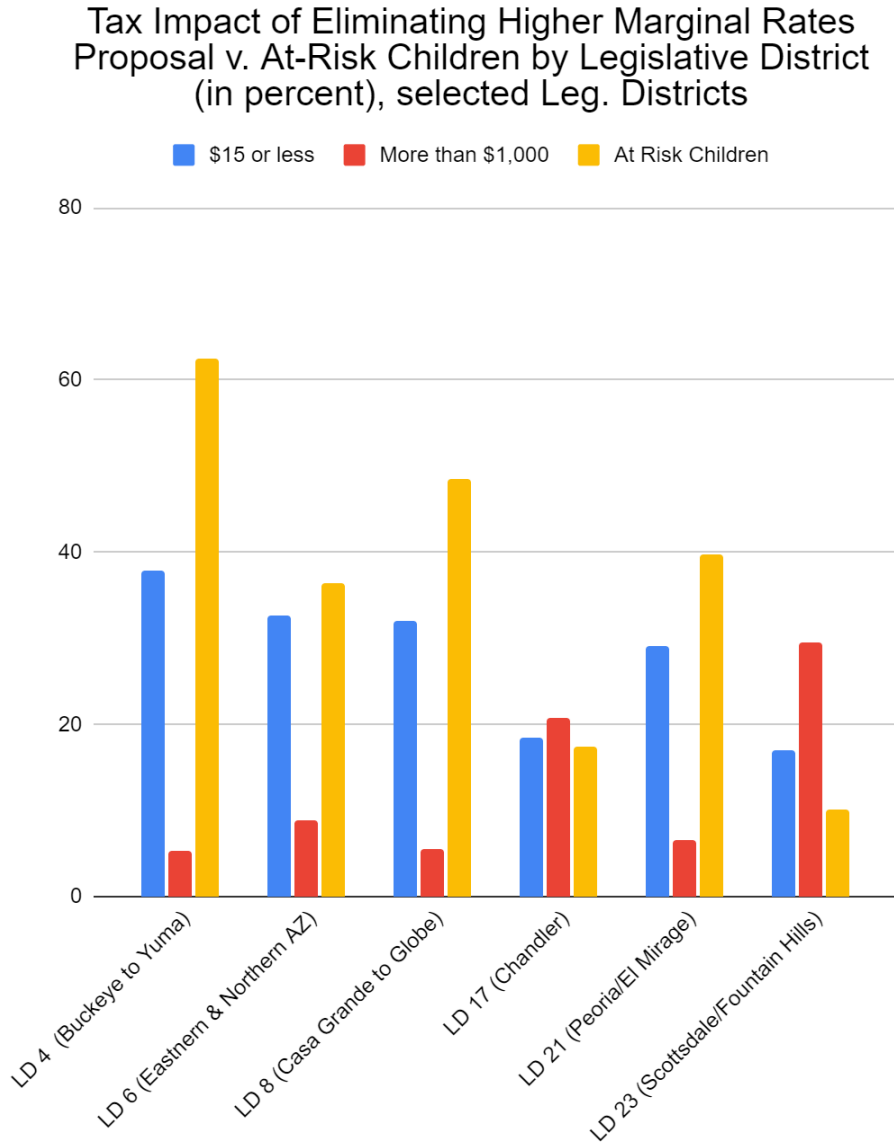
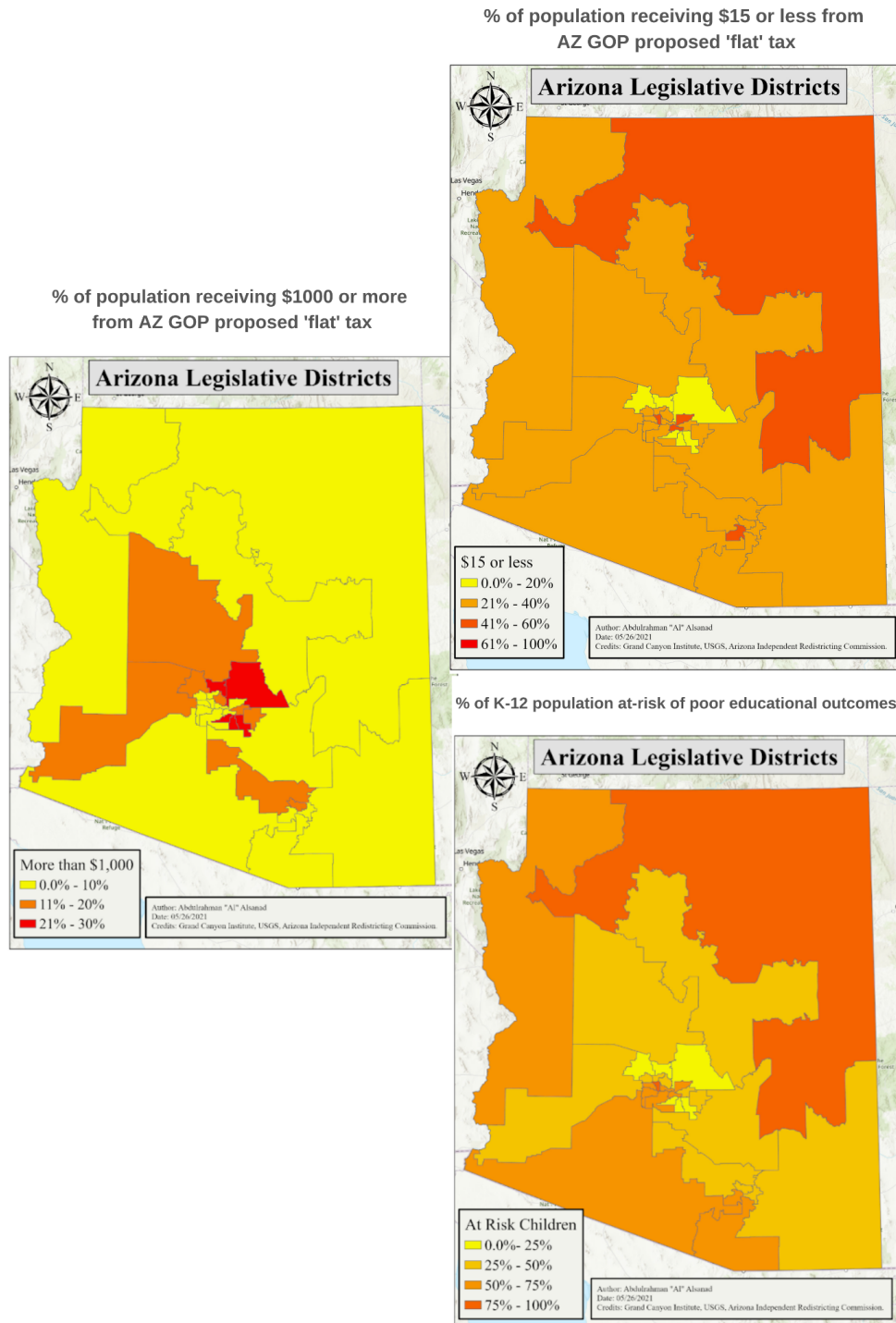


Figure 4



The Grand Canyon Institute (GCI) is dedicated to informing and improving public policy in Arizona through evidence-based, independent, objective, nonpartisan research. GCI makes a good faith effort to ensure that findings are reliable, accurate, and based on reputable sources. While publications reflect the view of the Institute, they may not reflect the view of individual members of the Board.

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The Grand Canyon Institute, a 501(c) 3 nonprofit organization, is a centrist think tank led by a bipartisan group of former state lawmakers, economists, community leaders, and academicians. The Grand Canyon Institute serves as an independent voice reflecting a pragmatic approach to addressing economic, fiscal, budgetary and taxation issues confronting Arizona.

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Appendix 1 Full Data by Legislative District, County, and Select Cities & Towns

Table A1

Legislative Districts (percent of households or children)

Comparative Impact of Tax Cuts v. Educational Investments in At-Risk Youth				
By Legislative District				
Legislative District	Major Cities/Towns	% of Population Who Will Save		% of At-Risk
		\$15 or less	More than \$1,000	Children
LD 1	Anthem Cordes Lakes Prescott	27.2	12.4	25.6
LD 2	Elgin Green Valley Nogales Tucson	37	5.9	68.64
LD 3	Tucson	43.4	4.3	72.32
LD 4	Buckeye Gila Bend Sells Yuma	37.9	5.4	62.56
LD 5	Bullhead City Colorado City Kingman Lake Havasu City	39.7	4.9	62.56
LD 6	Flagstaff Sedona Snowflake Payson	32.7	8.9	36.48
LD 7	Page San Carlos Showlow Tuba City Winslow	47.2	4.5	79.84

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Legislative District	Major Cities/Towns	% of Population Who Will Save		% of At-Risk
		\$15 or less	More than \$1,000	Children
LD 8	Casa Grande Coolidge Globe San Manuel San Tan Valley	32	5.6	48.48
LD 9	Casa Adobes Catalina Foothills North Tucson	33.3	13.1	49.6
LD 10	Tucson	32.5	8.5	49.6
LD 11	Casa Grande Marana Maricopa Oro Valley	21.3	13.4	33.28
LD 12	Gilbert Queen Creek	12.2	24.4	11.36
LD 13	Buckeye Wellton Wickenburg Yuma	24.5	11.3	27.84
LD 14	Benson Clifton Douglas Safford Sierra Vista Willcox	30.5	8.7	41.12
LD 15	Phoenix	15.8	22	17.12
LD 16	Apache Junction East Mesa	25.8	10.1	33.6
LD 17	Chandler	18.5	20.8	17.44
LD 18	Tempe Chandler West Mesa Ahwatukee	15.2	21.4	15.52
LD 19	Avondale Phoenix Tolleson	27.2	6.4	55.04

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Legislative District	Major Cities/Towns	% of Population Who Will Save		% of At-Risk
		\$15 or less	More than \$1,000	Children
LD 20	Glendale Phoenix	28	8	41.6
LD 21	El Mirage Peoria Surprise	29.1	6.5	39.68
LD 22	Peoria Glendale Surprise	18.6	15.6	16.96
LD 23	Fountain Hills Phoenix Scottsdale	17	29.6	10.08
LD 24	Phoenix Scottsdale	35.6	8.3	57.44
LD 25	Mesa	27.9	12	34.08
LD 26	North Tempe Salt River-Pima Maricopa Indian Community West Mesa	40.3	4.8	59.2
LD 27	Laveen Gila River Indian Community Guadalupe Phoenix South Phoenix	33.3	7.2	59.68
LD 28	Paradise Valley Phoenix	26.2	19.8	35.04
LD 29	Glendale Phoenix	34.8	5.1	65.6
LD 30	Glendale Phoenix	46.6	3.3	76.8

Table A2

Counties (percent of households or children)

	\$15 or less	More than \$1,000	At-Risk Children
Apache	52.4	2.7	76.8
Cochise	36.3	6.5	61.6
Coconino	30.1	11.5	38.72
Gila	40.2	5.3	73.44
Graham	34.9	4.8	48.32
Greenlee	21.4	5.8	Not Available
La Paz	50.4	2.7	Not Available
Maricopa	22.5	15.6	30.72
Mojave	38.5	5	62.08
Navajo	44.1	5.1	76.48
Pima	30.9	10.2	42.24
Pinal	28.9	7.5	44.8
Santa Cruz	44.8	6.1	78.4
Yavapai	32.9	6.9	34.24
Yuma	39.2	4.8	60.32
ARIZONA	26.2	12.8	36.64

Appendix 2 Tax Methodology

The Arizona Department of Revenue (ADOR) breakdown of the 2017 personal income tax returns was used to estimate marginal tax thresholds and liabilities of various income classes.²

The American Community Survey reports income by households (our unit of analysis) while the Arizona Dept. of Revenue reports data by filer, which we assume matches the concept of households. Households though can file as married jointly or head of

² Arizona Dept of Revenue, Individual Income Tax Statistics: Tax Year 2017, [abstract \(azdor.gov\)](https://www.azdor.gov/abstract).

household and face different marginal tax thresholds than those who file as single or married filing separately (latter being rare).

GCI used the aggregate returns with the avg. tax liability for each income group provided by ADOR and weighted it based on the portion of filers for each group that were filing as married/head of household versus single/married separately to get a threshold for each marginal tax rate for that income group. If the threshold was HIGHER than the typical tax, then GCI presumes that everyone in that income group is paying that marginal tax rate.

GCI took the difference at the threshold from the proposed 2.5% tax rate to identify a difference and focused on those in the 2.59% tax bracket, who save \$15 at the threshold--so in practice would save up to that amount. The ADOR places an income cut at \$30,000 whereas the American Community Survey cuts at \$35,000. The primary income tax change since 2017 was the expanded standard deduction (that eliminated the personal exemption) from tax conformity with the federal Tax Cut and Jobs Act of 2017. The net effect increased the deductions for lower income households, so GCI assumes that \$35,000 is an approximate equivalent to the \$30,000 cut point in the ADOR data.

Higher income ranges are a bit more challenging to estimate due to the wider range of incomes included. ADOR provided a \$100,000-\$199,999 income group and GCI estimates that people at the lower end of that save less than \$1,000, but the \$1,000 savings occurs within that income bracket. The American community survey has a breakpoint at \$150,000 and GCI uses that as the estimated breakpoint for where tax reductions of more than \$1,000 occur.

In 2017 there were five tax brackets, whereas currently there are four tax brackets (plus the 3.5% surcharge on very higher earners).³ So the evaluation of tax bracket fit was based on those tax brackets and then translated to the current modified version.

The estimation is derived below based on ADOR data.

³ Arizona Tax Brackets 2017, [ADOR Announces 2017 Standard Deductions, Exemption Amounts and Tax Brackets | Arizona Department of Revenue \(azdor.gov\)](https://www.azdor.gov/newsroom/2017/04/20/2017-standard-deductions-exemption-amounts-and-tax-brackets)

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Table A3

Adjusted Gross Income	Average Tax	Returns	Portion Married or Head of Household	2.88% threshold (taxable income)	tax at threshold	2.5% tax	difference
<\$10,000	\$41	353,407	23%	\$12,684	\$329	\$317	\$11
\$10,000-\$19,999	\$162	416,357	39%	\$14,330	\$371	\$358	\$13
\$20,000-\$29,999	\$312	381,280	45%	\$15,001	\$389	\$375	\$14
\$30,000-\$49,999	\$631	529,136	49%	\$15,408	\$399		
\$50,000-\$74,999	\$1,008	378,517	59%	4.24% threshold (taxable income)			
\$75,000-\$99,999	\$1,692	241,903	73%	\$89,710	\$2,747		
\$100,000-\$199,999	\$3,092	340,636	84%	\$95,408	\$2,922	\$2,385	\$536
\$200,000-\$499,999	\$8,505	94,654	88%				
\$500,000-\$999,999	\$24,047	13,708	88%				
\$1,000,000-\$4,999,999	\$70,006	5,907	86%				
\$5,000,000-\$9,999,999	\$259,560	404	85%				
\$10,000,000 and more	\$1,244,598	226	77%				

The 2.59% low income rate has not changed since 2017. Based on the income ranges provided, the taxable income for up to \$29,999 fell under the maximum for the 2.59%. Due to the expanded standard deduction this was expanded to \$35,000 to translate to the American Community Survey. At the threshold, the tax change was about \$14. Note the taxable income threshold changes for each income group as a weighted average of

the formulas for married/head of household and single/married separately are taken to determine the threshold for the aggregated group. However, as illustrated in Table 1 and if the \$40,000 married couple had children, then their income could be even higher to reach only a \$14 savings from the collapsing marginal tax rates. This cut point is likely conservative, meaning more filers will be in the \$15 or less group, but due to data constraints \$35,000 is used.

The 4.24% income threshold does not fit the \$75,000 to \$99,999 AGI group. However, that threshold is crossed for the \$100,000 to \$199,999 group. In 2017 filers in the \$100,000-\$199,999 range had an average taxable income after deductions of \$96,308 with a tax liability of \$3,092. This was just above the threshold for the marginal tax rate of 4.24% (now 4.17% in the 4 rate system). At the threshold of \$95,408 taxable income the state tax in 2017 was \$2,922. So the typical household in this income group was slightly above the 4.24% threshold. But the range is \$100,000. Given Table 1's calculations and that this income group often has more tax deductions than lower income groups, the appropriate cut off point is likely somewhere between \$150,000 and \$200,000 for those saving \$1,000 or more, but due to data limitations, the lower amount was used. These households are less impacted by the rise in the standard deduction as they are more likely to itemize their deductions. If they began using the standard deduction after the 2017 tax reform, the difference between itemizing as they might have done through 2017 and the enhanced standard deduction would often be small.

Collectively, the \$150,000 breakpoint, therefore is an overestimate of when savings from a 2.5% rate would be \$1,000 or more.