LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS

200 W. Washington, Suite 301
Indianapolis, IN 46204
(317) 233-0696
http://www.in.gov/legislative

FISCAL IMPACT STATEMENT

LS 6676
BILL NUMBER: HB 1327

NOTE PREPARED: Jan 23, 2006
BILL AMENDED: Jan 19, 2006

SUBJECT: Update of References to the Internal Revenue Code.

FIRST AUTHOR: Rep. Espich
FIRST SPONSOR:

BILL STATUS: 2nd Reading - 1st House

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: *Dependent Child Deduction:* This bill corrects an obsolete reference to the Internal Revenue Code related to a state income tax deduction for dependents. For taxable years beginning after December 31, 2005, this bill expands the class of dependents that permit a taxpayer to take an additional $1,500 dependent state income tax deduction from "son, stepson, daughter, or stepdaughter who is not more than 19 years of age or a student" to any "son, stepson, daughter, stepdaughter, or foster child of the taxpayer, descendant of a son, stepson, daughter, stepdaughter, or foster child of the taxpayer, brother, sister, stepbrother, or stepsister of the taxpayer or a descendant of any such relative who is not more than 19 years of age, a student, or permanently and totally disabled".

Internal Revenue Code (IRC) Reference Update: The bill provides that for taxable years beginning after December 31, 2005, references in Indiana law to the IRC and related regulations refer to the law and regulations in effect on January 1, 2006.

Effective Date: January 1, 2005 (retroactive); January 1, 2006 (retroactive).

Explanation of State Expenditures: The Department of Revenue (DOR) will incur additional expenses to revise tax forms, instructions, and computer programs to reflect the changes contained in this bill. The Department's current level of resources should be sufficient to implement these changes.

Explanation of State Revenues: *Summary:* The bill: (1) updates the reference in state statute to the Internal Revenue Code from January 1, 2005, to January 1, 2006; and (2) expands the coverage of the dependent child deduction to include certain dependents other than a taxpayer's son, stepson, daughter, stepdaughter, or foster child who are currently covered. The estimated revenue impact of the bill is summarized in the table below.

Provisions (Revenue Impact in $M)	**FY 2006**	**FY 2007**	**FY 2008**
IRC Reference Update	(1.28)	(1.41)	(1.87)
Expansion of Dependent Child Deduction	0	(2.9)	(3.0)
Total	**(1.28)**	**(4.31)**	**(4.87)**

IRC Reference Update: The bill updates the reference to the IRC to incorporate all the federal changes made up to January 1, 2006. The current reference to the IRC pertains to all IRC provisions amended and in effect on January 1, 2005. The update would include changes affecting tax years 2005 and after as a result of the following federal acts:

(1) The Energy Tax Incentives Act of 2005 (P.L. 109-58);
(2) The Katrina Emergency Tax Relief Act of 2005 (P.L. 109-73);
(3) The Gulf Opportunity Zone Act of 2005 (P.L. 109-135).

The Energy Tax Incentives Act includes provisions relating to: (1) depreciation and expensing of natural gas distribution property, electricity transmission and distribution property, and certain refinery investments; (2) amortization of certain air pollution control facilities installed by electric generating companies; and (3) deduction for construction of energy-efficient commercial buildings.

The Katrina Emergency Tax Relief Act and the Gulf Opportunity Zone Act include provisions: (1) increasing corporate charitable contribution limits; (2) excluding from gross income charitable mileage reimbursements for volunteers; and (3) expanding the deduction for corporate contributions of food inventory to noncorporate entities, and extending the deduction to donations of books to public schools. A summary of the estimated revenue impact of these federal acts is outlined in the table below.

Provisions (Revenue Impact in $M)	FY 2006	FY 2007	FY 2008
Energy Tax Incentives Act			
(1) Depreciation and expensing provisions.	(0.13)	(0.44)	(1.17)
(2) Amortization provisions.	(0.05)	(0.14)	(0.29)
(3) Deduction for energy-efficient commercial buildings.	(0.17)	(0.36)	(0.20)
(4) Other provisions.	(0.44)	(0.32)	(0.21)
Subtotal	**(0.79)**	**(1.26)**	**(1.87)**
Katrina Emergency Tax Relief Act/Gulf Opportunity Zone Act			
Charitable contribution provisions.	(0.49)	(0.15)	0.0
Total Impact on State Revenue	**(1.28)**	**(1.41)**	**(1.87)**

Revenue from the corporate AGI Tax is distributed to the state General Fund. The revenue from the individual AGI Tax is deposited in the state General Fund (86%) and the Property Tax Replacement Fund (14%).

Dependent Child Deduction: The bill would reduce state Adjusted Gross Income (AGI) Tax liabilities for individual taxpayers who have dependents that currently do not qualify for the dependent child deduction. The revenue loss due to this change could potentially total about $2.9 M in FY 2007, with annual growth thereafter estimated to be about 1.5% annually.

Background: Under current law, a taxpayer may reduce his or her state taxable income by $1,500 per dependent child. For a taxpayer to claim the dependent child deduction, the dependent child must be (1) the taxpayer's son, stepson, daughter, stepdaughter, or foster child, and (2) either be under the age of 19 or a full-time student who is under the age of 24. The bill would expand the deduction to apply to: (1) a dependent grandchild, sibling, nephew, or niece of a taxpayer who meets the age requirements stated in (2) above; or (2) a dependent of a taxpayer who is permanently and totally disabled regardless of age.

The estimates of grandchildren and other qualifying dependents are based on: (1) analysis of the state taxpayer data relating to the federal dependent exemption and the state's dependent child deduction; and (2) survey research by the U.S. Census Bureau relating to cohabitation of grandchildren with grandparents, and adult children with parents.

Revenue from the AGI Tax on individuals is deposited in the state General Fund (86%) and the Property Tax Replacement Fund (14%). Since the deduction is effective beginning in tax year 2006, the fiscal impact would begin in FY 2007.

Explanation of Local Expenditures:

Explanation of Local Revenues: The IRC update and the expansion of the dependent child deduction could potentially affect taxable income of individual taxpayers. However, the impact on counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) is likely to be minimal.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties with local option income taxes.

Information Sources: Tom Conley, Department of State Revenue, (317) 232-2107; Bob Lain, State Budget Agency, (317) 232-3471. OFMA Income Tax Databases: 2002-2003. U.S. Congress, Joint Committee on Taxation, http://www.house.gov/jct/tableofcnts.html. U.S. Census Bureau, Current Population Reports: *Children's Living Arrangements and Characteristics: March 2002*, (P20-547), June 2003; *Coresident Grandparents and Grandchildren (P23-198)*, May 1999; *The Population 14 to 24 Years Old by College Enrollment*, June 1, 2001. U. S. Census Bureau, Census 2000, *Profile of General Demographic Characteristics (Indiana)*. U. S. Census Bureau, Current Population Survey, *Family Households, by Type, Age of Own Children, Age of Family Members, and Age, Race and Hispanic Origin of Householder: 2004*, June 29, 2005.

Fiscal Analyst: Jim Landers, 317-232-9869.