

COMMITTEE ON LEGISLATIVE RESEARCH  
OVERSIGHT DIVISION

**FISCAL NOTE**

L.R. No.: 0450-01  
Bill No.: HB 78  
Subject: Taxation and Revenue - Income, Corporations, Revenue Dept.  
Type: Original  
Date: March 23, 2011

Bill Summary: Would phase in a 50% exemption from state tax for business income, over 5 years.

**FISCAL SUMMARY**

<b>ESTIMATED NET EFFECT ON GENERAL REVENUE FUND</b>			
FUND AFFECTED	FY 2012	FY 2013	FY 2014
General Revenue	(\$47,067,647 to \$77,328,328)	(\$93,862,082 to \$143,937,444)	(\$140,661,171 to \$209,284,215)
<b>Total Estimated Net Effect on General Revenue Fund</b>	<b>(\$47,067,647 to \$77,328,328)</b>	<b>(\$93,862,082 to \$143,937,444)</b>	<b>(\$140,661,171 to \$209,284,215)</b>

<b>ESTIMATED NET EFFECT ON OTHER STATE FUNDS</b>			
FUND AFFECTED	FY 2012	FY 2013	FY 2014
<b>Total Estimated Net Effect on <u>Other</u> State Funds</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>

Numbers within parentheses: ( ) indicate costs or losses.

This fiscal note contains 9 pages.

<b>ESTIMATED NET EFFECT ON FEDERAL FUNDS</b>			
<b>FUND AFFECTED</b>	<b>FY 2012</b>	<b>FY 2013</b>	<b>FY 2014</b>
<b>Total Estimated Net Effect on <u>All</u> Federal Funds</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>

<b>ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)</b>			
<b>FUND AFFECTED</b>	<b>FY 2012</b>	<b>FY 2013</b>	<b>FY 2014</b>
General Revenue	7	7	7
<b>Total Estimated Net Effect on FTE</b>	<b>7</b>	<b>7</b>	<b>7</b>

Estimated Total Net Effect on All funds expected to exceed \$100,000 savings or (cost).

Estimated Net Effect on General Revenue Fund expected to exceed \$100,000 (cost).

<b>ESTIMATED NET EFFECT ON LOCAL FUNDS</b>			
<b>FUND AFFECTED</b>	<b>FY 2012</b>	<b>FY 2013</b>	<b>FY 2014</b>
<b>Local Government</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>

## FISCAL ANALYSIS

### ASSUMPTION

Officials from the **Office of the Secretary of State (SOS)** assume many bills considered by the General Assembly include provisions allowing or requiring agencies to submit rules and regulations to implement the act. The SOS is provided with core funding to handle a certain amount of normal activity resulting from each year's legislative session. The fiscal impact for this fiscal note to the Secretary of State's Office for Administrative Rules is less than \$2,500. The SOS recognizes that this is a small amount and does not expect that additional funding would be required to meet these costs. However, we also recognize that many such bills may be passed by the General Assembly in a given year and that collectively the costs may be in excess of what our office can sustain with our core budget. Therefore, we reserve the right to request funding for the cost of supporting administrative rules requirements should the need arise based on a review of the finally approved bills signed by the governor.

Officials from the **Office of Administration, Division of Budget and Planning (BAP)** assume the proposed legislation would not result in additional costs or savings to their organization.

This proposal would phase in an exemption, from individual and corporate income, of 50% of all "business income" by tax year 2015. "Business income" is not clearly defined in this proposal, but BAP assumes this would include all corporate income, and individual income reported as business income. However, other sources of income may also be exempted.

This proposal would reduce general and total state revenues, and BAP defers to the Department of Revenue for an estimate of reduced revenues.

Officials from the **Department of Revenue (DOR)** assume this proposal would provide an exemption from state income tax for a portion of every taxpayer's business income. The exemption would be phased in using the following percentages:

- \* Beginning January 1, 2011 - 10%
- \* Beginning January 1, 2012 - 20%
- \* Beginning January 1, 2013 - 30%
- \* Beginning January 1, 2014 - 40%
- \* Beginning January 1, 2015 - 50%

ASSUMPTION (continued)

DOR would create procedures by which the exemption is claimed and could create rules to implement the provisions. The provisions would sunset December 31, six years after the effective date unless reauthorized by the General Assembly.

DOR would need to make changes to tax forms and instructions, and DOR and ITSD-DOR would need to make programming changes to the Corporation Income Tax System (COINS), the Corporate and Franchise Tax System (CAFÉ), the Electronic Filing Specifications (MeFile), the Data Warehouse (EDW), the Individual Income Tax System (MINITS) and the Case Audit Management System (CAMS).

These exemptions would reduce corporation and individual income tax, and would cause an estimated \$702 million negative impact on Total State Revenue in the first five years of implementation as shown below.

Personal income tax

In 2008 there were 250,927 federal individual income tax returns filed by individuals with a Missouri address who reported business income totaling \$3,776,064,897. Those same taxpayers had an effective tax rate of 3.62% on all of their sources of income. The table below reflects the total reduction in tax for each tax year.

Year	Percent Exempted	Taxable Income Reduction	Tax Reduction
2011	10%	\$377,606,490	\$13,669,355
2012	20%	\$755,212,979	\$27,338,710
2013	30%	\$1,132,819,469	\$41,008,065
2014	40%	\$1,510,425,959	\$54,677,420
2015	50%	\$1,888,032,449	\$68,346,775

ASSUMPTION (continued)

Corporate income tax

In 2008 there were 18,817 Missouri corporate returns filed that reported \$5,300,314,210 in taxable income. That yielded a corporate tax of \$331,270,189. The table below reflects the total reduction in tax for each tax year.

Year	Percent Exempted	Taxable Income Reduction	Tax Reduction
2011	10%	\$530,331,421	\$33,126,964
2012	20%	\$1,060,062,842	\$66,253,928
2013	30%	\$1,590,094,263	\$99,380,891
2014	40%	\$2,120,125,684	\$132,507,855
2015	50%	\$2,650,157,105	\$165,634,819

Administrative cost

DOR officials assume that Personal Tax would require two additional Temporary Tax Employees for key entry, one additional FTE Revenue Processing Technician I (Range 10, Step L) per 19,000 additional errors, and one additional FTE Revenue Processing Technician I (Range 10, Step L) per 2,400 pieces of correspondence. In addition, Corporate Tax would require one additional FTE Revenue Processing Technician I (Range 10, Step L) per 2,600 additional pieces of correspondence, including one CARES phone and agent license, and one additional FTE Revenue Processing Technician I (Range 10, Step L) per 7,800 additional errors, including one CARES phone and agent license.

ASSUMPTION (continued)

DOR officials assume there would be an increase in adjustments to individual income tax returns due to the calculation to reduce taxable income; and therefore, Collections and Tax Assistance (CATA) would see an increase in contacts. DOR officials assume CATA would require one FTE additional Tax Collection Technician I (Range 10, Step L) for every additional 15,000 contacts annually to the non-delinquent tax line, including one CARES phone and agent license, one FTE additional Tax Collection Technician I (Range 10, Step L) for every additional 15,000 contacts annually to the delinquent tax line, including one CARES phone and agent license, and one additional FTE Revenue Processing Technician I (Range 10, Step L) for every additional 4,800 contacts annually to the field offices.

DOR officials provided an estimate of the administrative cost to implement this proposal including seven additional employees and the related equipment and expense totaling \$296,537 for FY 2012, \$297,888 for FY 2013, and \$300,998 for FY 2014.

**Oversight** has, for fiscal note purposes only, changed the starting salary for the additional positions to correspond to the second step above minimum for comparable positions in the state's merit system pay grid. This decision reflects a study of actual starting salaries for new state employees for a six month period and the policy of the Oversight Subcommittee of the Joint Committee on Legislative Research. Oversight has also adjusted the DOR estimate of equipment and expense in accordance with OA budget guidelines, and finally, Oversight assumes that a limited number of additional employees could be accommodated in existing office space.

**Oversight** also assumes the DOR estimate of expense and equipment cost for additional FTE could be overstated. If DOR is able to use existing equipment such as desks, file cabinets, chairs, etc., the estimate for equipment for fiscal year 2012 could be reduced by roughly \$5,000 per employee.

IT cost

DOR officials provided an estimate of the IT cost to implement this proposal of \$53,424 based on 2,016 hours of programming to make changes to DOR systems.

**Oversight** assumes ITSD-DOR is provided with core funding to handle a certain amount of activity each year. Oversight assumes ITSD-DOR could absorb the costs related to this proposal. If multiple bills pass which require additional staffing and duties at substantial costs, ITSD-DOR could request funding through the appropriation process.

ASSUMPTION (continued)

Officials from the **University of Missouri, Economic and Policy Analysis Research Center** (EPARC) assume this proposal would, if enacted, phase-in a 50% business income exemption for individual and corporate taxpayers over five years.

For 2011, ten percent of taxpayers' business income would be exempt from taxation. For the 2012, twenty percent of taxpayers' business income would be exempt from taxation. For 2013, thirty percent of taxpayers' business income would be exempt from taxation. For 2014, forty percent of taxpayers' income would be exempt from taxation. Finally, for 2015, fifty percent of taxpayers' income would be exempt from taxation. The following estimates were generated using the latest available corporate tax data from 2008 as well as the latest available individual income tax data from 2009. (Amounts in millions of dollars).

Year	Business Income Exemption	Corporate Income Tax Liability	Individual Income Tax Liability	Total Income Tax Liability	Change in Net General Revenue
Baseline	0%	\$369,862	\$4,395,185	\$4,765,047	\$0
2011	10%	\$332,876	\$4,355,114	\$4,687,990	(\$77,057)
2012	20%	\$295,890	\$4,325,489	\$4,621,379	(\$143,668)
2013	30%	\$258,903	\$4,297,132	\$4,556,035	(\$209,012)
2014	40%	\$221,917	\$4,270,300	\$4,492,217	(\$272,830)
2015	50%	\$184,931	\$4,245,189	\$4,430,120	(\$334,927)

**Oversight** has reviewed and compared the DOR and EPARC estimates of revenue reduction for this proposal as shown below. Oversight notes that these estimates were based on assumptions about the implementation of the proposal and on the definition of business income, which is subject to change by federal and state regulation. For fiscal note purposes only, Oversight will indicate a fiscal impact with a range as indicated by the DOR and EPARC estimates. Oversight assumes that the 2011 impact would be reflected on tax returns for 2011 which would mostly be filed in the second half of FY 2012.

ASSUMPTION (continued)

Year	DOR Estimated Personal Tax Reduction	DOR Estimated Corporate Tax Reduction	DOR Estimated Total Tax Reduction	EPARC Estimated Change in Revenue
2011	\$13,669,355	\$33,126,964	\$46,796,319	\$77,057,000
2012	\$27,338,710	\$66,253,928	\$93,592,638	\$143,668,000
2013	\$41,008,065	\$99,380,891	\$140,388,956	\$209,012,000
2014	\$54,677,420	\$132,507,855	\$187,185,275	\$272,830,000
2015	\$68,346,775	\$165,634,819	\$233,981,594	\$334,927,000

<u>FISCAL IMPACT - State Government</u>	FY 2012 (10 Mo.)	FY 2013	FY 2014
<b>GENERAL REVENUE FUND</b>			
Cost - Department of Revenue			
Salaries (7 FTE)	(\$145,300)	(\$173,478)	(\$175,212)
Benefits	(\$76,050)	(\$90,798)	(\$91,706)
Equipment and expense	<u>(\$49,978)</u>	<u>(\$5,168)</u>	<u>(\$5,297)</u>
Total	<u>(\$271,328)</u>	<u>(\$269,444)</u>	<u>(\$272,215)</u>
<u>Revenue reduction - business income exemption</u>	<u>(\$46,796,319 to \$77,057,000)</u>	<u>(\$93,592,638 to \$143,668,000)</u>	<u>(\$140,388,956 to \$209,012,000)</u>
<b>ESTIMATED NET EFFECT ON GENERAL REVENUE FUND</b>	<b><u>(\$47,067,647 to \$77,328,328)</u></b>	<b><u>(\$93,862,082 to \$143,937,444)</u></b>	<b><u>(\$140,661,171 to \$209,284,215)</u></b>
Estimated Net FTE Effect on General Revenue Fund	7	7	7

FISCAL IMPACT - Local Government

FY 2012  
(10 Mo.)

FY 2013

FY 2014

\$0

\$0

\$0

FISCAL IMPACT - Small Business

This proposal would have a direct fiscal impact to small businesses which have business income as defined in the proposal.

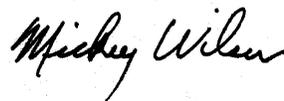
FISCAL DESCRIPTION

The proposed legislation would phase in a 50% exemption from state tax for business income, over 5 years.

This legislation is not federally mandated, would not duplicate any other program and would not require additional capital improvements or rental space.

SOURCES OF INFORMATION

Office of the Secretary of State  
Office of Administration  
    Division of Budget and Planning  
Department of Revenue  
University of Missouri  
    Economic and Policy Analysis Research Center



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