COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 4535-12
Bill No.: SCS for HCS for HB 1639
Subject: Corporations; Revenue Dept.; Taxation and Revenue - Income
Type: Original
Date: May 17, 2012

Bill Summary: Creates a phased-in individual income tax deduction for business income and reduces the corporate income tax rate over a five-year period.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2013	FY 2014	FY 2015
General Revenue	(Up to $111,062,721)	(Up to $218,667,148)	(Up to $325,114,201)
Total Estimated Net Effect on General Revenue Fund	**(Up to $111,062,721)**	**(Up to $218,667,148)**	**(Up to $325,114,201)**

Numbers within parentheses: ( ) indicate costs or losses.
This fiscal note contains 10 pages.

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2013	FY 2014	FY 2015
Total Estimated Net Effect on Other State Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2013	FY 2014	FY 2015
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2013	FY 2014	FY 2015
General Revenue	13	13	13
Total Estimated Net Effect on FTE	**13**	**13**	**13**

☐ 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).

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2013	FY 2014	FY 2015
Local Government	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

Officials from the **Office of the Secretary of State** (SOS) stated that 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 SOS 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.

ASSUMPTION (continued)

Officials from the **Joint Committee on Administrative Rules** assume this proposal would not have a fiscal impact to their organization in excess of existing resources.

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

Individual Income Tax

BAP officials also noted that this proposal would phase in a deduction of business income for individual income tax filers. The phase-in would begin in 2012, or the first year that state collections of net individual income and net corporate taxes exceed collections for those taxes in fiscal year 2010. The deduction would increase from 10% in the first year to 50% in the fifth year that revenues exceed the FY 2010 calculation, and would continue at 50% for subsequent years. Business income would be defined as income greater than zero arising from transactions and activity in the regular course of the taxpayer's trade or business, and would include income from tangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

BAP officials reported that the Internal Revenue Service (IRS) Statistics of Income (SOI) indicated a portion of dividend and capital gains income would also likely qualify as business income under this proposal and BAP officials estimated that 7.2-12.6% of net individual income taxes are derived from business income.

In FY 2011, $4,640.3 million was collected in net individual income taxes. Using the range presented above, between $334.1 million and $584.7 million in individual income taxes was derived from business income. Therefore, a 10% reduction in business income would reduce general and total state revenues by $33.4 million to $58.5 million beginning as early as FY 2013. In the year in which the 50% reduction becomes effective, General and Total State Revenues would be reduced by $167 million to $292.4 million annually, notwithstanding any inflationary growth.

Corporate Income Tax

This proposal would phase in a corporate income tax rate reduction. The phase-in would begin in 2012, or in the first year state collections of net individual income and net corporate taxes

ASSUMPTION (continued)

exceed the collections for those taxes in fiscal year 2010. The deduction would increase from 10% in the first year to 50% in the fifth year that revenues exceed the FY 2010-calculation, and would continue at 50% for subsequent years.

In FY 2011, $306.1 million was collected in net corporate income taxes. Therefore, each 10% reduction in the rate would reduce General and Total State Revenues by $30.6 million, beginning as early as FY 2013. In the year in which the 3.125% rate becomes effective, this proposal would reduce general and total state revenues by $153.1 million annually, notwithstanding any inflationary growth.

BAP also noted that FY2010 net corporate and individual income taxes were well below the FY 2008 peak.

Officials from the **University of Missouri, Economic and Policy Analysis Research Center** (EPARC) assume this proposal would, if enacted, gradually reduce the corporate tax rate as well as phase-in a "business income" subtraction from individual taxpayers' Federal Adjusted Gross Income when determining their Missouri Adjusted Gross Income. This proposal would also change the laws regarding the collection of money owed to the state, establish a tax amnesty program, and provide for additional sales tax exemptions.

Individual and Corporation Taxes

Beginning in 2012 the Office of Administration (OA) would compare the sum of net corporate and individual income tax collections from that fiscal year to net corporate and individual income tax collections from FY 2010. If OA determines that collections from that fiscal year are less than in FY 2010, the previous year's taxes code would remain in place.

* In the first year for which OA determines that collections are more than for FY 2010, individual filers would be allowed a "business income" subtraction of 10% for the following tax year, and the corporate income tax rate would be reduced to 5.625%.

* In the second year for which OA determines that collections are more than for FY 2010, individual filers would be allowed a "business income" subtraction of 20% for the following tax year, and the corporate income tax rate would be reduced to 5%.

ASSUMPTION (continued)

- * In the third year for which OA determines that collections are more than for FY 2010, individual filers would be allowed a "business income" subtraction of 30% for the following tax year and the corporate income tax rate would be reduced to 4.375%.

- * In the fourth year for which OA determines that collections are more than for FY 2010, individual filers would be allowed a "business income" subtraction of 40% for the following tax year and the corporate income tax rate would be reduced to 3.75%.

- * In the fifth year for which OA determines that collections are more than for FY 2010, individual filers would be allowed a "business income" subtraction of 50% for the following tax year and the corporate income tax rate would be reduced to 3.125%.

Business Income Subtraction for Individual Income Tax Filers

EPARC officials began by enumerating "business income" for the Missouri 1040. Business income was defined as income reported on Schedules C, E, and F.

Schedule C	$4.882 billion
Schedule E	$8.444 billion
Schedule F	$0.473 billion
Total	$13.799 billion

Based on the net tax due estimate from the Department of Revenue individual income tax data for 2010 as a baseline, EPARC estimated that net tax due would be reduced by $74.334 million if individual filers are allowed a 10% "business income" subtraction, $146.811 million if individual filers are allowed a 20% "business income" subtraction, $217.620 million if individual filers are allowed a 30% "business income" subtraction, $286.419 million if individual filers are allowed a 40% "business income" subtraction , and $352.816 million if individual filers are allowed a 50% "business income"subtraction.

ASSUMPTION (continued)

Corporate Tax Rate Reduction

EPARC officials noted that the latest 2009 corporate income tax data indicated an aggregate tax liability of $356.317 million. Based on that estimate, EPARC calculated a reduction in corporate tax liability of $35.632 million if the tax rate was reduced to 5.625%, a reduction of $71.263 million if the tax rae was reduced to 5%, a reduction of $106.895 million if the tax rate was reduced to 4.375%, a reduction of $142.527 million if the tax rate was reduced to 3.75%, and a reduction in tax liability of $178.158 million if the tax rate was reduced to 3.125%.

The EPARC estimates (in $ millions) could be summarized as shown in this chart.

Year	Corporate Tax Revenue	Corporate Tax Change	Personal Tax Revenue	Personal Tax Change
Baseline	$356.317	$0.000	$4,481.075	$0.000
1	$320.685	($35.632)	$4,406.741	($74.334)
2	$285.054	($71.263)	$4,334.264	($146.811)
3	$249.422	($106.895)	$4,263.455	($217.620)
4	$213.790	($142.527)	$4,194.656	($286.419)
5	$178.159	($178.158)	$4,128.259	($352.816)

Oversight notes that any change to individual or corporate tax revenues resulting from these provisions would be contingent on a determination by the Office of Administration that combined corporate and individual income tax revenues were greater than for FY 2010. For fiscal note purposes, Oversight will indicate a reduction in revenue "Up to" the amount estimated by EPARC for that year. Oversight also notes that this proposal would change the tax on business income for years beginning on or after January 1, 2012 and assumes the first returns filed under these provisions would be for 2012 and would be filed in January 2013 (FY 2013)

ASSUMPTION (continued)

Business Income Tax Reductions

Section 143.013 RSMo would create a reduction in the taxability of individuals' business income and Section 143.071 RSMo would reduce the Missouri corporate income tax rate. DOR officials did not provide an estimate of the revenue impact of these provisions.

IT Impact

The DOR response also included a total of $254,559 in IT cost for the Office of Administration, Information Technology Services Division staff assigned to OA-ITSD (DOR) based on 9,606 hours of programming for changes to DOR systems.

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

Officials from the **Department of Economic Development** assume this proposal would have no fiscal impact on their organization.

Officials from the **Department of Natural Resources** (DNR) noted that this proposal would create an additional sales tax exemption. DNR officials assume the additional exemption would reduce revenues for the Parks, and Soil and Water Tax which supports DNR.

FISCAL IMPACT - State Government	FY 2013 (10 Mo.)	FY 2014	FY 2015
GENERAL REVENUE FUND			
Cost - Department of Revenue			
Salaries (13 additional FTE)	($657,200)	($371,196)	($374,908)
Temporary employees	($13,000)	($15,756)	($15,914)
Employee benefits	($345,030)	($194,878)	($196,827)
Expense and equipment	($81,491)	($11,318)	($11,552)
Total	($1,096,721)	($593,148)	($599,201)
Revenue Reduction - Reduced individual business income taxability	(Up to $74,334,000)	(Up to $146,811,000)	(Up to $217,620,000)

Revenue reduction - Reduced corporate income tax rate	(Up to $35,632,000)	(Up to $71,263,000)	(Up to $106,895,000)
ESTIMATED NET EFFECT ON GENERAL REVENUE FUND	**(Up to $111,062,721)**	**(Up to $218,667,148)**	**(Up to $325,114,201)n**
Estimated Net FTE Effect on General Revenue Fund	13	13	13
SCHOOL DISTRICT TRUST FUND			

FISCAL IMPACT - Small Business

This proposal would have a fiscal impact on small business.

FISCAL DESCRIPTION

This proposal would reduce the tax on business income and corporate income.

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 Economic Development
Department of Natural Resources
Department of Revenue
Joint Committee on Administrative Rules
University of Missouri
    Economic and Policy Analysis Research Center
City of Columbia
City of Kansas City
St. Louis County

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