COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 4421-05
Bill No.: SB 497
Subject: Taxation and Revenue - Income
Type: Original
Date: January 13, 2014

Bill Summary: This proposal would reduce the maximum individual income tax rate over a period of years.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2015	FY 2016	FY 2017
General Revenue	$0	($383,958,790)	($383,977,689 to $1,576,698,689)
Total Estimated Net Effect on General Revenue Fund	**$0**	**($383,958,790)**	**($383,977,689 to $1,576,698,689)**

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2015	FY 2016	FY 2017
Total Estimated Net Effect on Other State Funds	**$0**	**$0**	**$0**

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

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2015	FY 2016	FY 2017
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2015	FY 2016	FY 2017
General Revenue	0	2	2
Total Estimated Net Effect on FTE	**0**	**2**	**2**

☒ 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 2015	FY 2016	FY 2017
Local Government	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

Section 143.011, RSMo. Individual Income Tax Rate Reduction

This proposal would modify the current individual income tax rate table. The maximum tax rate on personal income would be reduced to 5.5% for the 2015 calendar year, and would then be reduced by an additional 1.5% over a period of years. No further reduction could be implemented unless total net General Revenue Fund collections in the previous fiscal year exceeded the highest amount collected in the three preceding fiscal years by at least $100 million.

The amount of annual rate reduction would be calculated by dividing the amount by which net General Revenue Fund collections in the previous fiscal year exceeds the highest amount collected in the three preceding fiscal years and dividing such result by $100 million. That number would then be multiplied by 3/20% to determine the reduction to be applied to the maximum individual income tax rate in the previous calendar year. Additional rate reductions would be calculated in the same way each year until the maximum tax rate on individual income is reduced to four percent.

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

<u>ASSUMPTION</u> (continued)

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

BAP officials noted this proposal would reduce the top marginal individual income tax rate from 6% to 5.5%, effective Jan. 1, 2015. Based on Tax Year 2011 data, BAP officials estimate this proposal would reduce Total State Revenues by $343.8 million annually by FY 2016. However, BAP officials assume taxpayers would adjust withholdings and declarations beginning in January 2015. Those adjustment would reduce Total State Revenues in FY 2015 by an estimated $124 million.

This proposal would reduce the top marginal individual income tax rate to 4% through a phased-in series of reductions. Based on Tax Year 2011 data, BAP officials estimated this proposal would reduce Total State Revenues by $1.442 billion annually when fully phased-in.

The proposal would require the income tax rate to be incrementally reduced based on growth in net general revenues. The amount of rate reduction would be calculated by taking the amount that net General Revenue Fund collections in the previous fiscal year exceeded the highest amount collected in any of the three previous fiscal years and dividing such number by one hundred million. Such number would be rounded down to the nearest whole number and multiplied by three-twentieths of a percent. This percentage would then be subtracted from the maximum tax rate for the previous year to give the maximum tax rate for the current year. Based on Tax Year 2011 data, BAP officials estimated that each 0.15% reduction in the top tax rate would reduce Total State Revenues by $103-$112 million, depending on the current rate at the time of the reduction.

BAP officials provided the following example based on FY 2013 net General Revenue Fund collections of $8,083 million. That amount exceeded the highest of the previous three years by $742 million. Dividing $742 million by $100 million and rounding down provides a factor of seven. Seven multiplied by 3/20%, provides an income tax rate reduction of 1.05%. Based on Tax Year 2011 data, BAP officials estimates that a reduction in the top tax rate from 5.5% to 4.45% would reduce Total State Revenues by $733 million.

BAP officials assume this proposal would impact the calculation under Article X, Section 18(e).

ASSUMPTION (continued)

Officials from the **Department of Revenue (DOR)** assume this proposal would eliminate the current tax table structure after 2014. For 2015, the proposal would remove the "over $9,000" tax rate. Beginning in 2016, the top rate could be reduced once each year over a period of years. The reduction could only occur if net General Revenue Fund collections exceed the highest amount collected in any of the previous three fiscal years by $100 million. The proposal would eliminate tax rate brackets as the maximum rate is reduced below the rate for that bracket.

Fiscal impact

Based on the immediate reduction of the maximum individual income tax rate to 5.5 percent and assuming no additional reductions, the Department estimates a reduction in individual income tax of $343.8 million each year. If net General Revenue Fund collections exceed the highest amount collected in any of the previous three fiscal years by at least $100 million, the Department estimates a reduction in individual income of the following:

First Year:	$450.3 million
Second Year:	$556.7 million
Third Year:	$663.1 million
Fourth Year:	$771.8 million

DOR officials estimated the proposed reductions in individual income tax rates would create a negative impact of $1.4 billion when this legislation is fully implemented.

Administrative impact

DOR officials assume personal tax would need to make programming and form changes, and would require one additional Revenue Processing Technician for every 19,000 errors and one additional Revenue Processing Technician for every 2,400 pieces of correspondence.

In addition, DOR officials assume this proposal would lead to additional contacts to Collections & Tax Assistance (CATA) delinquent and non-delinquent call centers and the Jefferson City tax assistance office, resulting in the need for two additional Tax Collection Technicians I and one additional Revenue Processing Technician I.

ASSUMPTION (continued)

Finally, DOR officials assume Withholding Tax tables would need to be updated, but no additional staff would be required.

The DOR response included four additional employees; with benefits, equipment, and expense, the estimated DOR cost to implement this proposal was $154,395 for FY 2015, $164,35 for FY 2016, and $165,995 for FY 2017.

Oversight assumes the DOR estimate of expense and equipment cost for the new FTE could be overstated. If DOR is able to use existing desks, file cabinets, chairs, etc., the estimate for equipment could be reduced by roughly $6,000 per new employee.

Oversight will assume for fiscal note purposes that DOR could implement this proposal with two additional employees beginning in January, 2016 (FY 2016) when the first tax returns for 2015 would be filed. For fiscal note purposes only, Oversight has changed the starting salary for the additional employees 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 and 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. Finally, Oversight assumes a limited number of additional employees could be accommodated in existing office space.

IT impact

DOR officials provided an estimate of the IT impact for this proposal of $13,732 based on 504 hours of programming time on DOR systems.

Oversight assumes 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 appropriation process.

ASSUMPTION (continued)

Officials from the **University of Missouri, Economic and Policy Analysis Research Center (EPARC)** provided the following response.

EPARC officials assume this proposal, if enacted, would reduce the top rate of tax on personal income over a period of years. Specifically, in 2015 it would reduce the top tax rate to 5.5%. Then in 2016 and subsequent years it would reduce the top tax rate only if the amount of net General Revenue Fund collections in the previous fiscal year exceeds the highest amount of net General Revenue Fund collections in any of the three fiscal years prior to such year by at least one hundred million dollars. The amount of rate reduction would be calculated by taking the amount that net General Revenue Fund collections in the previous fiscal year exceeded the highest amount of net General Revenue Fund collections in any of the three fiscal years prior to such fiscal year, and then dividing such number by one hundred million dollars, rounded down to the nearest whole number and multiplied by three twentieths of a percent. The top rate of tax could not be reduced below four percent.

EPARC officials stated they were unable to predict future net General Revenue Fund collections, but would consider the maximum impact possible. EPARC officials prepared a simulation using the top income tax rate of 5.5% for 2015, and a second simulation assuming a growth in net General Revenue Fund collections that would reduce the top tax rate to 4% for 2016.

EPARC officials reported the Net Tax Due total from the latest 2012 individual income tax data as our baseline of $5,109.439 million. The EPARC simulation for a top income tax rate of 5.5% for 2015 indicated a Net Tax Due total of $4,725.534 million, a reduction of $383.905 million in 2015. The simulation for a top income tax rate to 4% for 2016 indicated Net Tax Due would be reduced to $3,532.813 million, a reduction of $1,576.626 million.

The following table summarizes the EPARC estimate of fiscal impact for this proposal.

Calendar Year	Fiscal Year	Maximum Tax Rate	Net Tax Due	Revenue Reduction
Baseline		6%	$5,109,439,000	
2015	2016	5.5%	$4,725,534,000	($383,905,000)
2016	2017	4.0%	$3,532,813,000	($1,576,626,000)

ASSUMPTION (continued)

Oversight will use the EPARC estimate of revenue reduction for fiscal note purposes, and will use the amounts indicated in the table above for this fiscal note. Oversight is aware that filers may choose to reduce their estimated tax payments or their income tax withholding in anticipation of reduced tax rates, and notes this could reduce revenues a year in advance of the fiscal year indicated in the EPARC simulation. For fiscal note purposes, however, Oversight will indicate the full fiscal impact of the tax changes as shown in the table.

Oversight will indicate a revenue reduction of $383,905,000 for 2015 (FY 2016) and revenue reduction in a range from $383,905,000 to $1,576,626,000 for 2016 (FY 2017) due to the uncertainty as to the actual amount of rate reduction that would be required by the proposal. That revenue reduction would be the fully implemented fiscal impact for this proposal.

FISCAL IMPACT - State Government	FY 2015	FY 2016 (6 Mo.)	FY 2017
GENERAL REVENUE FUND			
Cost - Department of Revenue Income tax changes Section 143.011			
Salaries	$0	($23,136)	($46,735)
Benefits	$0	($11,801)	($23,837)
Equipment and expense	$0	($18,853)	($2,117)
Total cost - DOR	$0	($53,790)	($72,689)
FTE change - DOR	$0	2 FTE	2 FTE
Revenue reduction Personal income tax changes Section 143.011	$0	($383,905,000)	($383,905,000 to $1,576,626,000)
ESTIMATED NET EFFECT ON GENERAL REVENUE FUND	**$0**	**($383,958,790)**	**($383,977,689 to $1,576,698,689)**
Estimated FTE effect on General Revenue Fund	0	2 FTE	2 FTE

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FISCAL IMPACT - Local Government	FY 2015	FY 2016	FY 2017
	$0	**$0**	**$0**

FISCAL IMPACT - Small Business

No direct fiscal impact to small businesses would be expected as a result of this proposal.

FISCAL DESCRIPTION

The proposed legislation would modify the individual income tax rate table. The maximum tax rate on personal income would be reduced to 5.5% for 2015. The maximum tax rate would then be reduced by an additional 1.5% over a period of years. Additional reductions would go into effect whenever net General Revenue Fund collections in the previous fiscal year exceeded the highest amount of net General Revenue Fund collections in any of the three fiscal years prior to that year by at least $100 million. The amount of rate reduction would be calculated each year by taking the amount of net General Revenue Fund collections in the previous fiscal year and subtracting the highest amount of net General Revenue Fund collections in the three fiscal years prior to that year, dividing such number by $100 million, and then multiplying that result by 3/20%. The year's maximum individual tax rate would be calculated by subtracting that percentage from the maximum individual income tax rate for the previous year . Once the proposal is fully phased in, the maximum individual income tax rate would be reduced to four percent.

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

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SOURCES OF INFORMATION

Office of the Secretary of State
Joint Committee on Administrative Rules
Office of Administration
    Division of Budget and Planning
Department of Revenue
University of Missouri
    Economic and Policy Analysis Research Center

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