COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.:	4948-01
Bill No.:	HB 1453
Subject:	Taxation and Revenue - General; Taxation and Revenue - Income
Type:	Original
Date:	February 25, 2014

Bill Summary: This proposal would change Missouri income tax laws.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2015	FY 2016	FY 2017
General Revenue	$0	$0 or ($220,098,908)	$0 or ($220,102,016 to $318,344,016)
Total Estimated Net Effect on General Revenue Fund *	**$0**	**$0 or ($220,098,908)**	**$0 or ($220,102,016 to $318,344,016)**

* Estimated impact in tenth incremental change ($879,389,000).

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2015	FY 2016	FY 2017
School District Trust	$0	$0 or $80,000,000	$0 or $80,000,000
Total Estimated Net Effect on Other State Funds	**$0**	**$0 or $80,000,000**	**$0 or $80,000,000**

Numbers within parentheses: ( ) indicate costs or losses.
This fiscal note contains 16 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 FTE	7 FTE	7 FTE
Total Estimated Net Effect on FTE	**0 FTE**	**7 FTE**	**7 FTE**

☐ 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 rates:

Changes to this provision would reduce the top marginal individual income tax rate from 6.0% to 5.0%, in a series of incremental 0.1% steps. Each reduction would be based on the previous year's collections, and could begin January 1, 2015.

Officials from the **Office of Administration - Division of Budget and Planning (BAP)** assume, based on 2011 data, that each 0.1% reduction in the rate would reduce Total State Revenues by at least $68.8 million, depending on the current rate in effect. If the first reduction occurs in 2015, taxpayers would adjust withholdings and declarations beginning in January 2015. This proposal could reduce Total State Revenues in FY 2015 by an estimated $24.8 million.

BAP officials assume the fully phased-in proposal would reduce Total State Revenues by an estimated $698.6 million.

BAP officials noted the language dedicating 40% of the $200 million in general revenue growth to the school district trust fund appears to be intended to fund the Foundation Formula, based on the proposed language "…until such time that the foundation formula is fully funded." However, the school district trust fund revenue does not go to the foundation formula, it is distributed to schools outside of the formula.

For fiscal note purposes, **Oversight** will include transfers to the School District Trust Fund in the amounts required by the proposal, assuming the transferred funds would be distributed to local school districts with other amounts in the fund.

Officials from the **Department of Revenue (DOR)** assume changes to this provision would reduce the top tax rate by 1/10th of one percent beginning in 2015. The top rate could not be reduced lower than five percent and the reduction could only occur if net general revenue collected in the previous year exceeds the highest amount collected in the previous 3 years by $200 million. The proposal would eliminate tax rate brackets as the percentage is reduced below the rate for that bracket.

ASSUMPTION (continued)

Fiscal impact

If net general revenue collections meet the threshold in the proposal, DOR officials estimated the following reductions in individual income tax revenue:

First Year:	$68.8 million	Sixth Year:	$414.8 million
Second Year:	$137.5 million	Seventh Year:	$485.7 million
Third Year:	$206.3 million	Eighth Year:	$556.7 million
Fourth Year:	$275.1 million	Ninth Year:	$627.6 million
Fifth Year:	$343.8 million	Tenth Year:	$698.6 million

The above figures reflect the possible overall reduction in revenue from individual income tax collections due to the rate reduction in Section 143.011.

Administrative Impact

DOR officials assume Personal Tax would require form changes and ITSD-DOR programming support to update systems to include the deduction. In addition, DOR officials assume two additional Revenue Processing Technicians I would be required for error correction and correspondence.

DOR officials assume the proposed language in sections 143.011 and 143.022 would have an impact on Collections and Tax Assistance (CATA) call centers and tax assistance offices. DOR officials assume there would be an increase in adjustments to individual income tax returns due to the calculation to reduce taxable income, and CATA would see an increase in contacts. Due to this increased activity, DOR officials assume CATA would require two additional Tax Collection Technicians I for additional contacts to the delinquent and non-delinquent tax call centers and one additional Revenue Processing Technician I for contacts annually to the tax assistance offices. Each additional technician would require CARES equipment and licenses.

DOR officials assume Withholding Tax would be required to update withholding tables for any changes in the tax rate, but would not require additional staff.

ASSUMPTION (continued)

IT impact

DOR officials provided an estimate of the IT impact to implement this provision of $13,759 based on 504 hours of programming for the new tax tables and rates.

Total DOR cost estimate

The DOR estimate of cost to implement this provision included five additional employees; with benefits, equipment, expenses, and IT cost, the DOR estimate total was $214,708 for FY 2015, $206,774 for FY 2016, and $208,926 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 notes this provision would have a fiscal impact if the net general revenue collection threshold is met, and would first have an impact in January, 2016 (FY 2016). Oversight will include employee DOR costs for six months of FY 2016 and range the impact from $0 (threshold not met) to the calculated cost (threshold is met).

Oversight has, for fiscal note purposes only, 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.

Section 143.022, RSMo. - Business income subtraction:

Changes to this provision would allow individuals to exclude up to 50% of business income from taxable income, in a series of incremental 5% steps. This proposal would define business income as that reported on Schedule C, and partnership income as reported on various federal forms.

ASSUMPTION (continued)

Officials from the **Office of Administration - Division of Budget and Planning (BAP)** assume the income which could be excluded would be roughly equal to income reported on Schedule E.

Based on 2011 data, BAP officials estimated the first 5% reduction would reduce Total State Revenues by $19.2 million. If the first reduction occurs for 2015, taxpayers would adjust withholdings and declarations beginning in January 2015. This proposal could reduce Total State Revenues in FY 2015 by an estimated $6.9 million.

BAP officials assume the fully phased-in provision would reduce Total State Revenues by an estimated $189.1 million.

BAP officials noted it is very difficult to identify MO-source business income from available data. If the proportion of taxable income that is MO-source income is greater than that estimated for this analysis, the loss of revenues would be higher.

Also, BAP officials noted this analysis makes no attempt to quantify the loss of revenues that might occur if taxpayers alter their filing status to take advantage of the business income subtraction.

Officials from the **Department of Revenue (DOR)** assume changes to this provision would allow for the subtraction of business income from individuals' federal adjusted gross income. Additionally, the proposal would allow owners of small corporations or partnerships a deduction based on their share of ownership of the business.

Fiscal impact

DOR officials noted for 2011, individual income tax filers reported $14.4 billion in "business" income on their federal Form 1040s. The Department included the totals reported on Schedule C and Schedule E in the calculation. Of the $14.4 billion reported, DOR officials estimated that Missouri source income would be $9.8 billion. DOR officials also noted the $14.4 billion does not include those returns filed by nonresidents where the federal information is not available.

ASSUMPTION (continued)

If net general revenue collections meet the threshold in the proposal, DOR officials estimated the following reduction in individual income tax:

First Year:	$19.3 million	Sixth Year:	$114.1 million
Second Year:	$38.4 million	Seventh Year:	$133.0 million
Third Year:	$57.3 million	Eighth Year:	$151.9 million
Fourth Year:	$76.3 million	Ninth Year:	$170.7 million
Fifth Year:	$95.2 million	Tenth Year:	$189.6 million

Administrative Impact

DOR officials assume Personal Tax would be required to make form changes, and would require ITSD-DOR programming support to update systems to include the deduction. In addition, DOR officials assume two additional Revenue Processing Technicians I would be required for error correction and correspondence.

IT impact

For individual tax, DOR officials provided an estimate of the IT impact to implement this provision of $13,759 based on 504 hours of programming to update DOR systems. For corporate tax, DOR officials assumed the IT impact would be $41,278 based on 1,512 hours of programming.

Oversight will include the estimated IT cost total of ($13,759 + $41,278) = $55,037 in this fiscal note.

Total DOR cost estimate

The DOR estimate of cost to implement this provision included two additional employees; with benefits, equipment, expenses, and IT cost, the DOR estimate total was $135,416 for FY 2015, $82,709 for FY 2016, and $83,570 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.

ASSUMPTION (continued)

Oversight notes this provision would have an impact if the net general revenue collection threshold is met, and would first have an impact in January, 2016 (FY 2016). Oversight will include employee DOR costs for six months of FY 2016 and range the impact from $0 (threshold not met) to the calculated cost (threshold is met).

Oversight has, for fiscal note purposes only, 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.

Personal income tax provisions:

Officials from the **University of Missouri - Economic and Policy Analysis Research Center (EPARC)** provided the following response for the combined impact of the personal income tax changes.

If enacted, this proposal would reduce the top individual income tax rate and allow a "business income" subtraction for individual income tax filers whenever "the amount of net general revenue collected in the previous fiscal year exceeds the highest amount of net general revenue collected in any of the three previous fiscal years prior to such fiscal year by at least $200 million. When this $200 million or more growth in net general revenue contingency is met, 40% of this $200 million or more will be deposited into the school district trust fund and 20% of this $200 million or more will be designated for the support of higher education."

Specifically, in any year when the aforementioned $200 million net general revenue growth contingency is met, the top individual tax rate would be reduced by one-tenth of one percent until the top individual tax rate equals 5%, and the "business income" subtraction would be increased by 5% until the maximum allowable "business income" subtraction of 50% is reached.

EPARC officials noted that portions of this bill that allot monies to the school district trust fund and higher education would not impact net general revenue collections.

ASSUMPTION (continued)

EPARC officials noted their baseline simulation for individual income taxes current provisions and the latest 2012 individual income tax data indicated Net Tax Due would be $5,109.439. EPARC provided simulations for the changes to individual income tax provisions as shown in the following table.

Year	Maximum Income Tax Rate	Business Income Subtraction	Estimated Net Tax Due	Estimated Revenue Reduction
Baseline	6%	0	$5,109,439,000	$0
1	5.9%	5%	$5,015,962,000	($93,477,000)
2	5.8%	10%	$4,924,087,000	($185,352,000)
3	5.7%	15%	$4,833,288,000	($276,151,000)
4	5.6%	20%	$4,743,479,000	($365,960,000)
5	5.5%	25%	$4,654,628,000	($454,811,000)
6	5.4%	30%	$4,564,460,000	($544,979,000)
7	5.3%	35%	$4,475,256,000	($634,183,000)
8	5.2%	40%	$4,387,064,000	($722,375,000)
9	5.1%	45%	$4,299,878,000	($809,561,000)
10	5.0%	50%	$4,213,720,000	($895,719,000)

Oversight will use the EPARC estimates of fiscal impact for this fiscal note. Oversight notes the provisions would become effective January 1, 2015 if the net general revenue collections requirement is met and will indicate a revenue reduction of $0 or the EPARC projection for these provisions. Oversight assumes the first fiscal impact to the state would be in January, 2016 (FY 2016) when tax returns for 2015 would be filed. For 2016 (FY 2017). Oversight will indicate a fiscal impact of $0 or the range from the first year impact to the second year impact since it is not possible to predict whether the net general revenue targets wold be met for the years ended June 30, 2014 or June 30, 2015.

Oversight recognizes that taxpayers may adjust their estimated tax payments of withholding taxes but for fiscal note purposes will indicate the full impact when the tax returns are filed.

ASSUMPTION (continued)

Section 143.071,RSMo. - Corporate income tax rate:

Changes to this provision would reduce the corporate income tax rate from 6.25% to 5.25%, in ten 0.1% increments.

Officials from the **Office of Administration - Division of Budget and Planning (BAP)** stated FY 2013 net corporate income tax collections were $360.8 million. Therefore, BAP officials estimated each 0.1% reduction would reduce Total State Revenues by $5.8 million. If the rate is reduced for 2015, this may lead to reduced estimated payments in FY 2015 of an estimated $1.7 million.

Officials from the **Department of Revenue (DOR)** assume if net general revenue collected is at least $200 million over the greatest amount of net general revenue collected in the previous three years, the tax rate would drop by 1/10th of one percent. This provision would reduce the corporate income tax rate from 6 ¼% to 5 ¼% over 10 years.

Fiscal impact

DOR officials noted for calendar year 2011, 18,155 corporate taxpayers reported total taxable income of $5.78 billion. Based on these figures the Department estimates the following reduction in corporate income tax:

First Year:	$5.8 million	Sixth Year:	$34.7 million
Second Year:	$11.6 million	Seventh Year:	$40.5 million
Third Year:	$17.3 million	Eighth Year:	$46.3 million
Fourth Year:	$23.1 million	Ninth Year:	$52.0 million
Fifth Year:	$28.9 million	Tenth Year:	$57.8 million

Administrative Impact

DOR officials noted there would be form changes, but the proposal would not be effective until January 1, 2015, DOR officials assume Corporate Tax could roll the changes into the other year-end tax changes.

ASSUMPTION (continued)

IT impact

DOR officials assume the IT cost to implement this provision would be $9,173 based on 336 hours of programming to make changes to DOR systems.

Oversight notes this provision would have an impact if the net general revenue collection threshold is met, and would first have an impact in January, 2016 (FY 2016). Oversight will range the impact from $0 (threshold not met) to the calculated cost (threshold is met).

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

This proposal would reduce the corporate income tax rate by one-tenth of 1% each year the $200 million growth in net general revenue contingency is met until the corporate tax rate equals 5.25%. BAP officials noted the latest 2011 corporate income tax data indicates an aggregate corporate tax liability of $397.939 million and estimated the fiscal impact of the rate reductions as shown in the following table.

	Corporate Income Tax Rate	Estimated Corporate Tax Liability	Estimated Revenue (Reduction)
BASELINE	6.25%	$397,939,000	$0
Year 1	6.15%	$391,572,000	($6,367,000)
Year 2	6.05%	$385,205,000	($12,734,000)
Year 3	5.95%	$378,838,000	($19,101,000)
Year 4	5.85%	$372,471,000	($25,468,000)
Year 5	5.75%	$366,104,000	($31,835,000)
Year 6	5.65%	$359,737,000	($38,202,000)
Year 7	5.55%	$353,370,000	($44,569,000)
Year 8	5.45%	$347,003,000	($50,936,000)
Year 9	5.35%	$340,636,000	($57,303,000)
Year 10	5.25%	$334,269,000	($63,670,000)

ASSUMPTION (continued)

Oversight will use the EPARC estimates of fiscal impact for this fiscal note. Oversight notes the provisions would become effective January 1, 2015 if the net general revenue collections requirement is met and will indicate a revenue reduction of $0 or the EPARC projection for these provisions. Oversight assumes the first fiscal impact to the state would be in January, 2016 (FY 2016) when tax returns for 2015 would be filed. For 2016 (FY 2017) Oversight will indicate a fiscal impact of $0 or the range from the first year impact to the second year impact since it is not possible to predict whether the net general revenue targets would be met.

Oversight recognizes that taxpayers may adjust their estimated tax payments of withholding taxes but for fiscal note purposes will indicate the full impact when the tax returns are filed.

Finally, Oversight will include the required annual transfer of $80 million to the School District Trust Fund and the required annual $40 million expenditure for higher education funding. Oversight will include $0 or the required amounts since it is not possible to predict whether the net general revenue targets would be met.

Bill as a whole responses

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 that this proposal would not have a fiscal impact to their organization in excess of existing resources.

ASSUMPTION (continued)

Officials from the **Office of Administration - Division of Budget and Planning (BAP)** did not indicate any direct fiscal impact to their organization, and Oversight assumes this proposal would not result in any additional costs or savings to their BAP.

BAP officials noted this proposal would make numerous changes to income taxation provisions. Since several of the changes impact the individual income tax, the combined impact of the changes may differ from the sum of their estimates.

FISCAL IMPACT - State Government	FY 2015 (10 Mo.)	FY 2016	FY 2017
GENERAL REVENUE FUND			
Cost - DOR			
Personal income tax rates			
Section 143.011			
Salaries (5 FTE)	$0	$0 or ($59,100)	$0 or ($119,382)
Benefits	$0	$0 or ($30,144)	$0 or ($60,891)
Equipment and expense	$0	$0 or ($39,199)	$0 or ($4,405)
IT cost	$0	$0 or ($13,759)	$0
Total	$0	$0 or ($142,202)	$0 or ($184,678)
Cost - DOR			
Personal business income subtraction			
Section 143.022			
Salaries (2 FTE)	$0	$0 or ($23,640)	$0 or ($47,753)
Benefits	$0	$0 or ($12,058)	$0 or ($24,356)
Equipment and expense	$0	$0 or ($12,798)	$0 or ($1,229)
IT cost	$0	$0 or ($55,037)	$0
Total	$0	$0 or ($103,533)	$0 or ($73,338)
FTE change - DOR	0 FTE	7 FTE	7 FTE
Revenue reduction - DOR Personal business income tax changes Sections 143.011 and 143.022 *	$0	$0 or ($93,477,000)	$0 or ($93,477,000 to $185,352,000)

* Estimated impact in tenth incremental change ($815,719,000)

FISCAL IMPACT - State Government (Continued)	FY 2015 (10 Mo.)	FY 2016	FY 2017
Cost - DOR Corporate income tax rates Section 143.071 IT cost	$0	$0 or ($9,173)	$0
Revenue reduction - DOR Corporate income tax rates Section 143.071 *	$0	$0 or ($6,367,000)	$0 or ($6,367,000 to $12,734,000)
* Estimated impact in tenth incremental change ($63,670,000)			
Cost - Higher education funding Section 143.011	$0	$0 or ($40,000,000)	$0 or ($40,000,000)
Transfer - School District Trust Fund Section 143.011	$0	$0 or ($80,000,000)	$0 or ($80,000,000)
ESTIMATED NET EFFECT ON GENERAL REVENUE FUND *	**$0**	**$0 or ($220,098,908)**	**$0 or ($220,102,016 to $318,344,016)**
* Estimated impact in tenth year ($879,389,000)			
Estimated Net FTE effect on General Revenue Fund	0 FTE	7 FTE	7 FTE
SCHOOL DISTRICT TRUST FUND			
Transfer - General Revenue Fund Section 143.011	$0	$0 or $80,000,000	$0 or $80,000,000
ESTIMATED NET EFFECT ON SCHOOL DISTRICT TRUST FUND	**$0**	**$0 or $80,000,000**	**$0 or $80,000,000**

FISCAL IMPACT - Local Government	FY 2015 (10 Mo.)	FY 2016	FY 2017
	$0	**$0**	**$0**

FISCAL IMPACT - Small Business

This proposal would reduce income taxes for incorporated small businesses, and would provide an income tax reduction for owners of qualified businesses.

FISCAL DESCRIPTION

This proposal would change Missouri income tax laws. Provided a net general revenue collections increase requirement is met, the proposal would gradually reduce personal and corporate income tax rates.

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

SAS:LR:OD

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

Mickey Wilson

Mickey Wilson, CPA
Director
February 25, 2014

Ross Strope
Assistant Director
February 25, 2014

SAS:LR:OD