

COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 5992-09
Bill No.: Truly Agreed To and Finally Passed SS for SCS for HB 1865
Subject: Corporations; Taxation and Revenue - Income; Taxation and Revenue - Sales and Use; Utilities
Type: Original
Date: June 12, 2014

Bill Summary: This proposal would modify certain provisions relating to taxation.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2015	FY 2016	FY 2017
General Revenue	(Up to \$23,586,400)	(Up to \$25,303,680)	(Up to \$25,303,680)
Total Estimated Net Effect on General Revenue Fund	(Up to \$23,586,400)	(Up to \$25,303,680)	(Up to \$25,303,680)

Numbers within parentheses: () indicate costs or losses.
This fiscal note contains 13 pages.

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2015	FY 2016	FY 2017
School District Trust	(\$1,717,275 to \$2,862,133)	(\$2,060,730 to \$3,434,560)	(\$2,060,730 to \$3,434,560)
Conservation Commission	(\$214,659 to \$357,767)	(\$257,591 to \$429,320)	(\$257,591 to \$429,320)
Parks, and Soil and Water	(\$171,728 to \$286,213)	(\$206,073 to \$343,456)	(\$206,073 to \$343,456)
Total Estimated Net Effect on <u>Other</u> State Funds	(\$2,103,662 to \$3,506,113)	(\$2,524,394 to \$4,207,336)	(\$2,524,394 to \$4,207,336)

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2015	FY 2016	FY 2017
Total Estimated Net Effect on <u>All</u> Federal Funds	\$0	\$0	\$0

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

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 143.451, RSMo. - Corporate Income Tax on Interstate Transactions:

Officials from the **Office of Administration - Division of Budget and Planning (BAP)** assume these provisions would expand an additional method for allocating taxable corporate income. Based on updated information provided by the Department of Revenue, BAP officials estimated this provision may reduce Total State Revenues by up to \$15 million annually.

Officials from the **Department of Revenue (DOR)** stated these provisions would modify how a taxpayer computes the portion of income from all sources for intangible property or services for compensation in Missouri. A sale of intangible property would be considered in this state if the purchaser uses the property in this state. If the property is used in multiple states, the provisions would allocate the income pro rata to the portion of use in Missouri.

DOR officials estimated the loss to Total State Revenue from this provision could be as much as \$15 million annually.

DOR officials stated their calculation used 2011 information because that is the most recent year for which the Department has complete corporate information. DOR officials stated their understanding of the language in these provisions was to eliminate the current "partially within/partially without" category from the one-factor and three-factor allocation procedures and make sales either "in" or "out" of Missouri for corporate income tax reporting purposes. DOR officials also stated they assumed the new provisions would primarily apply to services.

DOR officials stated they calculated their estimate of impact by eliminating the reported "partially" sales for corporations with a cost of sales percentage under 50% for companies based in Missouri assuming those sales were services and would be reported as "outside" Missouri under the proposed language.

Oversight notes this provision includes definitions to use in allocating the taxable income from multi-state transactions to determine the taxable amount for Missouri. Oversight does not have information regarding the number or amount of transactions which might be subject to those definitions. For fiscal note purposes, Oversight will indicate a reduction in income tax revenues up to the Department of Revenue estimate of \$15 million.

ASSUMPTION (continued)

Section 144.055, RSMo. - Sales Tax Exemption for Utilities Used in Food Preparation:

Officials from the **Office of Administration - Division of Budget and Planning (BAP)** assume this proposal would exempt from sales tax the utilities used in food preparation by restaurants and other food preparers. These exemptions would include the utilities, chemicals, machinery, equipment, supplies, parts and materials.

BAP officials stated the Department of Revenue provided information indicating that 25,000 different establishments may qualify for this exemption.

- * Based on information from the National Restaurant Association, the monthly utility cost for restaurants is about \$2,500. Using this estimate suggests this exemption could reduce Total State Revenue by \$31.7 million, of which \$22.5 million would be General Revenue.
- * Energy Star reports the average monthly restaurant utility cost per square foot is \$2.79, and the National Restaurant Association estimates an average eatery is about 2000 square feet. Using these estimates suggests this exemption could reduce Total State Revenue by \$70.7 million, of which \$50.2 million would be General Revenue.
- * BAP officials assume the proposed language may include food manufacturing as well as food preparation.
- * Because of the broad nature of the language, this provision could be construed to exempt from sales tax all utilities from any restaurant, cafeteria, fast food restaurant, delicatessen, bakery, grocery store, convenience store, or other similar facility.
- * BAP officials assume the impact would be between these two estimates, roughly \$51.2 million of Total State Revenue, of which \$36.4 million would be General Revenue.

BAP officials provided the following table of the estimated revenue reductions, and noted actual losses may exceed this estimate since the data above does not include "convenience stores" or other miscellaneous food preparers. BAP officials also noted actual losses may be less than their estimate, to the extent sales taxes are not currently being collected on such transactions.

ASSUMPTION (continued)

Oversight notes the \$36.4 estimated revenue reduction for the General Revenue Fund would imply underlying sales of $(\$36,400,000 / .03) = \$1,213,333,333$. Oversight will round this estimate to \$1.2 billion for convenience; the indicated revenue reduction for those state funds which receive sales tax revenues is shown in the following table.

Fund	Sales Tax Rate	Revenue Reduction (Millions)
General Revenue	3%	\$36.0
School District Trust	1%	\$12.0
Conservation Commission	1/8%	\$1.5
Parks, and Soil and Water	1/10%	\$1.0

Oversight also notes this provision would not provide an exemption from local sales taxes. Oversight also notes that the School District Trust Fund and other funds are distributed to school districts, but will not show that transfer.

Officials from the **Department of Revenue (DOR)** assume this proposal would provide an exemption from sales tax for electrical energy or gas, water, or other utilities purchased by a restaurant, cafeteria, fast food restaurant, delicatessen, bakery, grocery store, as well as machinery, equipment, parts, and material, used in the preparation of food sold to customers at a restaurant, cafeteria, fast food restaurant, bakery, grocery store, for consumption on or off the premises of the establishment. The exemption would not apply to local sales tax.

Fiscal impact

DOR officials estimated this section would result in a reduction of Total State Revenue as much as \$20 million for the utilities exemption, and as much as \$80 million or more for the exemption on chemicals, machinery, equipment, supplies, parts, and materials.

Administrative Impact

DOR noted the Department would need to create claim forms and instructions, and assume Sales Tax would need one additional Revenue Processing Technician I for every 500 new refund claims.

ASSUMPTION (continued)

The DOR estimate of cost to implement this proposal included three additional employees; the total including salary, benefits, equipment, and expenses totaled \$120,120 for FY 2015, \$124,065 for FY 2016, and \$125,354 for FY 2017.

Oversight assumes this proposal would be implemented primarily by the businesses in the food service industry; for example, by separate utility meters and specific accounting for exempt purchases, and would not require significant additional processing by DOR staff. Accordingly, Oversight assumes the proposal could be implemented with existing DOR staff; if unanticipated costs are incurred or if multiple proposals are implemented which increase the DOR workload, resources could be requested through the budget process.

IT impact

DOR officials provided an estimate of the IT cost to implement this proposal of \$18,346 based on 672 hours of programming to make changes to 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.

Officials from the **Department of Agriculture** and the **Department of Economic Development - Public Service Commission** and **Office of Public Counsel** assumed similar provisions in a previous version of this proposal would have no fiscal impact on their organizations.

Officials from the **University of Missouri - Economic and Policy Analysis Research Center (EPARC)** assumed similar provisions in another proposal would allow a sales and use tax exemption for utilities used or consumed in the preparation of food.

ASSUMPTION (continued)

EPARC officials estimated the amount of receipts that food preparation establishments in Missouri pay sales and use tax upon to be \$9.540 billion dollars. Therefore, at the current 3% sales tax rate we estimate food preparation establishments remit approximately \$286.213 million in sales tax. According to IRS corporate return data, within the food preparation service industry the cost of goods sold is approximately 72% of receipts and research of the industry standard yielded the cost of utilities as 3 to 5 percent of cost of goods sold. Using these statistics, we approximate the aggregate cost of utilities for Missouri’s food preparation establishments between \$206.073 million and \$343.456 million. Based on this range of costs, we approximate the 3% sales and use tax to be retained by food preparation establishments to be between \$6.182 million and \$10.304 million.

Oversight notes that any additional revenue reduction which could be attributed to the cost of machinery and parts used in the production of food could be ignored for the purposes of this fiscal note, and will use the EPARC estimate of amounts exempted from sales tax. The Oversight estimate of sales tax which would be lost as a result of this exemption is shown in the following table.

Fund	Sales Tax Rate	Ten months		Twelve months	
		From	To	From	To
General Revenue	3.000%	\$5,151,825	\$8,586,400	\$6,182,190	\$10,303,680
School District Trust	1.000%	\$1,717,275	\$2,862,133	\$2,060,730	\$3,434,560
Conservation Commission	0.125%	\$214,659	\$357,767	\$257,591	\$429,320
Parks, and Soil and Water	0.010%	\$171,728	\$286,213	\$206,073	\$343,456

ASSUMPTION (continued)

Bill as a whole responses

Officials from the **Department of Agriculture**, the **Department of Economic Development** and the **Joint Committee on Administrative Rules** each assume this proposal would not have a fiscal impact to their organization.

In response to similar language in other proposals, 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.

<u>FISCAL IMPACT - State Government</u>	FY 2015 (10 Mo.)	FY 2016	FY 2017
GENERAL REVENUE FUND			
<u>Revenue reduction</u> - allocation of interstate sales income Section 143.451	(Up to \$15,000,000)	(Up to \$15,000,000)	(Up to \$15,000,000)
<u>Revenue reduction</u> - food preparation costs sales tax exemption Section 144.055	(\$5,151,825 to \$8,586,400)	(\$6,128,190 to \$10,303,680)	(\$6,128,190 to \$10,303,680)
ESTIMATED NET EFFECT ON GENERAL REVENUE FUND	(Up to <u>\$23,586,400</u>)	(Up to <u>\$25,303,680</u>)	(Up to <u>\$25,303,680</u>)

<u>FISCAL IMPACT - State Government</u> (Continued)	FY 2015 (10 Mo.)	FY 2016	FY 2017
CONSERVATION COMMISSION FUND			
<u>Revenue reduction</u> - food preparation costs sales tax exemption Section 144.055	(\$214,659 to <u>\$357,767</u>)	(\$257,591 to <u>\$429,320</u>)	(\$257,591 to <u>\$429,320</u>)
ESTIMATED NET EFFECT ON CONSERVATION COMMISSION FUND	(\$214,659 to <u>\$357,767</u>)	(\$257,591 to <u>\$429,320</u>)	(\$257,591 to <u>\$429,320</u>)
PARKS, AND SOIL AND WATER FUND			
<u>Revenue reduction</u> - food preparation costs sales tax exemption Section 144.055	(\$171,728 to <u>\$286,213</u>)	(\$206,073 to <u>\$343,456</u>)	(\$206,073 to <u>\$343,456</u>)
ESTIMATED NET EFFECT ON PARKS, AND SOIL AND WATER FUND	(\$171,728 to <u>\$286,213</u>)	(\$206,073 to <u>\$343,456</u>)	(\$206,073 to <u>\$343,456</u>)
SCHOOL DISTRICT TRUST FUND			
<u>Revenue reduction</u> - food preparation costs sales tax exemption Section 144.055	(\$1,717,275 to <u>\$2,862,133</u>)	(\$2,060,730 to <u>\$3,434,560</u>)	(\$2,060,730 to <u>\$3,434,560</u>)
ESTIMATED NET EFFECT ON SCHOOL DISTRICT TRUST FUND	(\$1,717,275 to <u>\$2,862,133</u>)	(\$2,060,730 to <u>\$3,434,560</u>)	(\$2,060,730 to <u>\$3,434,560</u>)

<u>FISCAL IMPACT - Local Government</u>	FY 2015 (10 Mo.)	FY 2016	FY 2017
	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>

FISCAL IMPACT - Small Business

This proposal would have a direct fiscal impact to small businesses which have interstate sales or which prepare food for human consumption.

FISCAL DESCRIPTION

Currently, in determining what portion of a corporation's income is taxable in Missouri, the business may use a method whereby the ratio of instate sales to total sales is multiplied by the net income. A method for determining whether sales of tangible property are to be considered instate is already established in current law. This bill specifies a process for all other sales.

For sales of real property or rentals of tangible personal property, the portion of the property sold or rented that is located in this state will be considered an instate sale. For sales of service, the portion of the benefits delivered to purchasers in this state will be considered an instate sale.

For rentals or licenses of intangible property, the portion used in this state by the rentee or licensee will be considered an instate sale. Intangible property used for marketing will be considered used in this state if the good or service being marketed is purchased by a consumer in this state. Franchise fees or royalties for intangible property are considered used in this state if the franchise is located in this state.

For sales of intangible property, the portion of the sale used in this state will be considered an instate sale. If the sale is for the right to conduct business activity in a certain geographic area, the sale will be instate if the geographic area is in this state. If receipts for sales of intangible property are dependent on use or productivity, the sale must be considered a lease or rental of intangible property. All sales of intangible property other than the right to conduct business in a specific area or sales with receipts contingent on productivity or use will be excluded from the sales factor when determining corporate income tax. If it cannot be determined or reasonably approximated that a sale occurs in this state, the sale must be excluded from the sales factor for corporate income taxation.

FISCAL DESCRIPTION (continued)

The bill authorizes a state sales and use tax exemption for electricity, water, gas, coal, other energy sources or other utilities used or consumed in the manufacturing, processing, preparing, furnishing, compounding, or producing of food that is ultimately sold to customers for consumption on or off the premises at a restaurant, cafeteria, fast food restaurant, delicatessen, bakery, grocery store, convenience store, or other similar facility engaged in selling prepared food or that is used in research and development related to the activities.

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
Joint Committee on Administrative Rules
Office of Administration
 Division of Budget and Planning
Department of Agriculture
Department of Economic Development
Department of Revenue
St. Louis County
City of Jefferson City
City of Kansas City



Mickey Wilson, CPA
Director
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Ross Strope
Assistant Director

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