

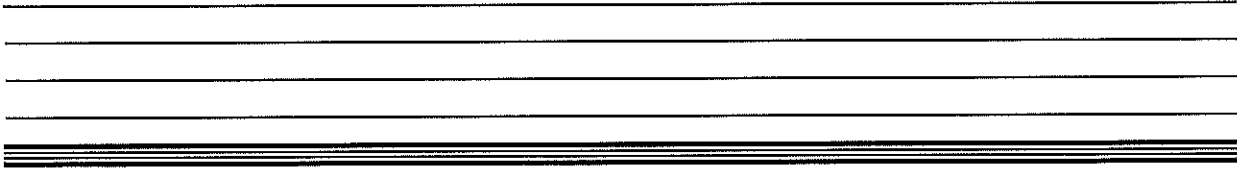
Oversight Division

Committee On Legislative Research

SUNSET REVIEW

**BIG GOVERNMENT
GET OFF MY BACK ACT**

Small Business Deduction for New Jobs



Sunset Review

BIG GOVERNMENT GET OFF MY BACK ACT

Small Business Deduction for New Jobs

*Prepared for the Committee on Legislative Research
by the Oversight Division*

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Committee on Legislative Research Oversight Subcommittee

THE COMMITTEE ON LEGISLATIVE RESEARCH, Oversight Division, is an agency of the Missouri General Assembly as established in Chapter 23 of the Revised Statutes of Missouri. The programs and activities of the State of Missouri cost approximately \$24.0 billion annually. Each year the General Assembly enacts laws which add to, delete or change these programs. To meet the demands for more responsive and cost effective state government, legislators need to receive information regarding the status of the programs which they have created and the expenditure of funds which they have authorized. The work of the Oversight Division provides the General Assembly with a means to evaluate state agencies and state programs.

THE COMMITTEE ON LEGISLATIVE RESEARCH is a permanent joint committee of the Missouri General Assembly comprised of the chairman of the Senate Appropriations Committee and nine other members of the Senate and the chairman of the House Budget Committee and nine other members of the House of Representatives. The Senate members are appointed by the President Pro Tem of the Senate and the House members are appointed by the Speaker of the House of Representatives. No more than six members from the House and six members from the Senate may be of the same political party.

Sunset reviews are assigned to the Oversight Division pursuant to Sections 23.250 to 23.298. After August 28, 2003, any new program authorized by the General Assembly shall sunset not more than six years after its effective date unless reauthorized by the General Assembly. The Oversight Division shall conduct a performance evaluation of the program as set forth in statute and prepare a written report. The report shall make recommendations on the sunset, continuation, or reorganization of a program.

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**COMMITTEE ON LEGISLATIVE RESEARCH
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Members of the General Assembly:

The Joint Committee on Legislative Research is required by Section 23.259.1(3), RSMo to conduct performance evaluations of sunset programs to determine and evaluate program performance in accordance with program objectives, responsibilities, and duties as set forth by statute or regulation. The Oversight Division has reviewed the following programs:

- Alternative Fuel Infrastructure Tax Credit
- Breast Cancer Awareness Trust Fund
- Rebuild Missouri Schools Program
- Wartime Veteran's Survivors Grant Program
- Big Government Get Off My Back Act Income Tax Deduction

The reports include Oversight's comments on (1) the sunset, continuation, or reorganization of the programs, and on the need for the performance of the functions of the programs; (2) the duplication of program functions; (3) the appropriation levels for each program for which sunset or reorganization is recommended; and possibly (4) drafts of legislation necessary to carry out the committee's recommendations pursuant to (1) and (2) above.

We hope this information is helpful and can be used in a constructive manner for the betterment of the state program to which it relates. You may obtain a copy of the reports from the Oversight Division website at <http://www.moga.mo.gov/htmlpages/losunsetreview.html>.

Respectfully,


Senator Brad Lager
Chairman

EXECUTIVE SUMMARY

The Small Business Deduction for New Jobs program (Section 143.173, RSMo) was added to the Big Government Get Off My Back Act in 2011 to provide additional incentives for small businesses which create new jobs. The program is administered entirely by the Department of Revenue (DOR).

The program provides an income tax deduction for each new job created by a small business from January 1, 2011 to December 31, 2014. The deduction is ten thousand dollars for each new job if the annual salary is at least equal to the county average wage; or twenty thousand dollars if the small business also offers health insurance and pays at least fifty percent of employee health insurance premiums. The new employees must work an average of at least thirty-five hours per week to qualify.

In 2012, the definitions of “small business” and “taxpayer” were expanded to include entities such as a sole proprietorship, partnership, S-corporation, C-corporation, limited liability company, limited liability partnership, or any other business entity with fewer than fifty employees.

Oversight noted the number of claims filed for this program was relatively low, ten in FY 2012 for \$320,000 and ninety-five in FY 2013 for a total of \$1,794,524.

Oversight was not permitted to review any detailed information for applicants or deduction claims in this program based on the DOR interpretation of Section 32.057, RSMo. Based on our review of DOR procedures, however, Oversight would like to point out two concerns.

- * We noted DOR requires employers to certify that new employees were not employed by the small business or an affiliate during the twelve months prior to the creation of the new job even though that requirement is not included in state law and DOR has not issued any regulations for the program.
- * We also noted DOR does not require documentation of health insurance coverage or premium payment by the employer even though eligibility for the larger deduction in this program requires the employer to offer health insurance coverage for all employees and pay at least half the premium cost.

Oversight does not offer a recommendation as to the reauthorization or termination of this program; however, if the program is continued we recommend DOR issue regulations regarding previous employment of qualifying new employees and require documentation of health insurance coverage and premium payment.

Chapter 1

Purpose/Objectives

The General Assembly has provided by law that the Joint Committee on Legislative Research will conduct a performance evaluation of a program subject to the Missouri Sunset Act. The committee shall consider the criteria as listed in Section 23.268, RSMo in determining whether a public need exists for the continuation of a program, or for the performance of the functions of the program. A sunset review is the regular assessment of the continuing need for a state program to exist. A sunset review answers the basic questions of what has happened to this program since its inception and does the State of Missouri continue to “need” the services provided by the program.

The Joint Committee on Legislative Research directed the Oversight Division to conduct a Sunset Review of the Missouri Department of Revenue’s Small Business Deduction for New Jobs, Section 143.173, RSMo, a part of the Big Government Get Off My Back Act. This report provides the status on the Small Business Deduction for New Jobs program as created by Truly Agreed To and Finally Passed Senate Substitute for Senate Committee Substitute for House Committee Substitute for House Bill 45 in the 2011 legislative session, and fulfills the requirement as established by Section 23.268, RSMo.

The Oversight Division review addressed, but was not limited to the following:

1. Compiling and reviewing data related to the program since its inception.
2. Analyzing changes to the program and other related events since its inception.

Scope

The Oversight Division obtained information on the Small Business Deduction for New Jobs program from 2011 through 2013; however, the Oversight Division analysis was limited to a review of summary data reported by the Department of Revenue (DOR) for the program. DOR officials declined to provide access to detailed information about the program based on the Department’s interpretation of the confidentiality requirements in Section 32.057, RSMo.

Methodology

The Oversight Division obtained information on the Small Business Deduction for New Jobs program through review of statutes, and by correspondence and interviews with DOR staff.

Background

Truly Agreed To and Finally Passed Senate Substitute for Senate Committee Substitute for House Committee Substitute for House Bill 45 from the 2011 legislative session added the Small Business Deduction for New Jobs program in Section 143.173, RSMo to the “Big Government Get Off My Back Act”. The program is managed by the Department of Revenue.

Provisions in the act authorized an income tax deduction for each new job created by a small business as defined in the act, beginning on or after January 1, 2011 and ending December 31, 2014. Creating a new job with an annual salary of at least the county average wage would make the small business eligible for a deduction of ten thousand dollars; the deduction increases to twenty thousand dollars for a new job if the small business also offered health insurance and paid at least fifty percent of the health insurance premiums for the employee. If the county average wage where the business is located is higher than the statewide average wage, the statewide average wage is considered the county average wage for that business.

The new employees must be considered full-time by the taxpayer and work an average of at least thirty-five hours per week for a fifty-two week period, and the taxpayer’s claim is limited to the number of full-time employees that exceeds the number of full-time employees employed by the small business in Missouri on the same date of the immediately preceding year.

Changes were made to the program by Truly Agreed To and Finally Passed House Committee Substitute for House Bill 1661 in the 2012 legislative session. The definitions of “small business” and “taxpayer” for the program were expanded to include entities such as a sole proprietorship, partnership, S-corporation, C-corporation, limited liability company, limited liability partnership, or any other business entity with fewer than fifty full- or part-time employees. The changes made these pass-through business entities eligible for the program.

The provisions in Section 143.173, RSMo include an automatic sunset three years from their effective date; therefore, the program is to sunset on August 28, 2014 unless reauthorized by the General Assembly. No changes have been made to the sunset language of this section of statute after the enabling legislation was passed; therefore, the provisions are currently scheduled to expire on August 28, 2014, and terminate September 1, 2015.

Department of Revenue

The Missouri Department of Revenue (DOR) serves as the central collection agency for most taxes and fees due the state. The Department is also responsible for motor vehicle titling and registration, and issuing drivers’ licenses. DOR redeems tax credits for programs assigned to the Department and tax credits administered by other state agencies, when they are submitted in lieu of payments by Missouri taxpayers.

Chapter 2

Comments

Application Process

A business which intends to claim the deduction must complete the Small Business Deduction for New Jobs Form - MO NJD (02-2013) and submit that form with its income tax return. The application form requires the business name and address, type of business, number of employees, and pay information for each new employee listed on the form. Upon receipt of the completed application form, the Department of Revenue reviews and verifies the information for accuracy and completeness. This review process is done manually. When the application form is accepted, the tax return is processed.

DOR Verification Procedures

DOR officials provided Oversight with a copy of their written procedures for verification of the MO-NJD form. The procedures include clear instructions on verifying information on the form.

- * Wages paid are recalculated by DOR staff and compared to the county average wage reported by the Missouri Economic Research and Information Center (MERIC), the economic research entity for the Department of Economic Development.
- * DOR staff also verifies that wages reported in the claim form were reported to the Department of Labor and Industrial Relations, Division of Employment Security.

The instructions also include clear procedures in case information on the form indicates the applicant does not qualify for the deduction, including the specific notices which must be sent to the filer.

In our review of the DOR process, we noted two situations which we believe should be addressed.

- * DOR forms include a requirement that a qualifying new employee in the program must not have been employed in Missouri by the small business, or any business affiliated with the small business, for a period of 12 months prior to the creation of the new job.

Oversight notes that requirement is not specified in state law for this program, nor has the Department of Revenue issued any regulations for the program. DOR officials told us they believe this definition is an interpretation which does not require a formal regulation, since Section 536.010.(6)(m), RSMo exempts forms, returns, and instruction booklets from the definition of a regulation.

- * DOR forms and procedures do not include a process for verifying health insurance coverage for employers who claim the \$20,000 deduction for each new employee. DOR officials stated they rely on the employer's attestation on the signed tax return form.

Oversight notes that an attached federal return would include the employer's cost of employee benefit plans, and the filer could provide the total program cost and a computation of the employer's cost as a percentage of total cost.

No Review of Files by Oversight

Oversight was not allowed to review any detailed information for applicants or deduction claims in this program. The Department of Revenue has consistently maintained their position that such information is confidential based on their interpretation of Section 32.057, RSMo. Since Oversight was not allowed to review any of the supporting detail for this program, we were not able to assess whether the written DOR procedures provided to Oversight are adequate, whether they are actually followed, or whether reported information for this program is accurate.

Deduction Recipients

DOR officials provided us with the number and amount of claims for this program. Oversight also requested DOR officials provide a list of filers who claimed this tax deduction; however, DOR officials stated they could not provide us the information as it is confidential under their interpretation of Section 32.057, RSMo.

Table 1 - Small Business Deduction for New Jobs Claims

<u>Year</u>	<u>Number of Claims</u>	<u>Deductions Claimed</u>	<u>Tax Revenue Reduction (at assumed 6% rate)</u>
FY 2011	0	\$0	\$0
FY 2012	10	\$320,000	\$19,200
FY 2013	95	\$1,794,524	\$107,672

Source: Department of Revenue

Oversight notes the Department of Revenue data reported above is limited to the overall number of claim forms filed and deductions claimed on those forms.

Oversight also notes that an employer with qualifying new employees would file one claim form with its tax return regardless of the number of new employees, and one new employee would entitle the employer to a deduction of \$10,000 or \$20,000 for each new employee in this program.

The deduction amounts claimed will not necessarily match the number of claims filed at \$10,000 or \$20,000 per new employee since the program allows employers such as limited partnerships and limited liability corporations to allocate those deductions among partners, shareholders, and other owners in accordance with the provisions of any agreement among such owners. If the employer and the owners have different tax years or if some of the owners filed extensions for their tax returns, those deductions would not necessarily be processed in the same year as the qualifying employees were hired.

Economic Impact

As noted above, the number of businesses participating in this program increased from FY 2012 to FY 2013; however, the number of claims remains relatively low. Officials from the Department of Economic Development (DED) told us the number of private sector payroll businesses with fewer than 50 employees is 136,129.

Subsequent Legislative Action

In 2012, the General Assembly adopted Truly Agreed to and Finally Passed House Committee Substitute for House Bill No. 1661 which changed the definition of “small business” and “taxpayer”. The new language added, clarified, and expanded the types of business eligible for the program. No change was made to the sunset language; therefore, this program is still scheduled to expire on August 28, 2014 and terminate December 31, 2015.

Possible Program Changes

Department of Revenue officials did not suggest any potential changes to this program.

Oversight Recommendation

- A. Oversight does not offer a recommendation as to the reauthorization or termination of this program.
- B. Oversight notes the program could possibly have been expanded with more publicity but assumes business owners would become aware of this program from the Department of Revenue website and trade publications; further, Oversight assumes that most business income tax returns would be prepared by tax professionals or corporate officials who would be aware of the program.
- C. Oversight recommends the Department of Revenue clarify by regulation the definition of a qualifying new employee, and develop procedures for verifying the payment of health insurance premiums by employers who claim the \$20,000 deduction for new employees.