COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 4324-02
Bill No.: SB 509
Subject: Business and Commerce; Taxation and Revenue - Income
Type: Original
Date: January 15, 2014

Bill Summary: This proposal would modify provisions relating to income taxes.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2015	FY 2016	FY 2017
General Revenue *	($87,142)	($163,256,210)	($163,300,453 to $268,931,453)
Total Estimated Net Effect on General Revenue Fund *	**($87,142)**	**($163,256,210)**	**($163,300,453 to $268,931,453)**

* Fully implemented revenue reduction in the tenth step would be ($945,477,000)

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 18 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	4 FTE	4 FTE
Total Estimated Net Effect on FTE	**0**	**4 FTE**	**4 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

This proposal would make several changes in current Missouri income tax provisions.

Sections 143.011, 143.022, and 143.151, RSMo. - Personal Income Tax Changes:

Changes to Section 143.011, RSMo, would gradually reduce the maximum individual income tax rate. Beginning January 1, 2015, the Director of the Department of Revenue would be required to adjust the tax tables by rule each year in which 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 fiscal years prior to such fiscal year by at least one hundred million dollars.

Each reduction in the maximum tax rate would be one-tenth of a percent, and no more than one reduction could be made in a calendar year. The reductions would take effect on January first of a calendar year and would continue in effect until the next reduction occurs. The reductions would only apply to tax years that begin on or after a modification takes effect. The maximum individual tax rate could not be reduced below five percent.

Section 143.022, RSMo, would provide a deduction of a percentage of the amount of business income reported by individuals from proprietorships, partnerships, and small corporations. Beginning January 1, 2015 there would be a ten percent deduction, provided 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 fiscal years prior to such fiscal year by at least one hundred million dollars. An additional deduction would take effect each year in which the required increase in net general revenue collections was met, and the deduction would be increased by ten percent each year until the maximum deduction of fifty percent of reported business income takes effect.

Changes to Section 143.151, RSMo, would allow an individual filer with Missouri adjusted gross income under twenty thousand dollars to take an additional deduction of one thousand dollars; an additional deduction would be allowed a spouse if the spouse also had Missouri adjusted gross incocme less than twenty thousand dollars.

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

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

Individual Income Tax Rate

This proposal 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 previous year's collections, beginning January 1, 2015. Based on 2011 data, BAP officials estimated 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 for 2015, taxpayers would adjust withholdings and declarations beginning in January 2015. BAP officials assume this proposal could reduce Total State Revenues in FY 2015 by an estimated $24.8 million.

When fully phased-in, the proposal would reduce Total State Revenues by an estimated $698.6 million.

Personal Business Income Subtraction

This proposal would allow an exclusion for up to 50% of business income from taxable income, in a series of incremental 10% steps. The proposal would define business income as that reported on Schedule C and partnership income. BAP officials assumed partnership income means Schedule E. Based on 2011 data, BAP officials estimated the first 10% reduction would reduce Total State Revenues by $38.3 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 $13.8 million.

When fully phased-in, the proposal would reduce Total State Revenues by an estimated $189.1 million.

ASSUMPTION (continued)

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

Also, BAP officials noted their 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.

Additional Individual Deduction

This provision would provide an additional deduction of $1,000 from Missouri Adjusted Gross Income for taxpayers with less than $20,000 of adjusted gross income. Based on 2011 data, BAP officials estimated this proposal would reduce Total State Revenues by $21.7 million annually. Since the provision would be implemented in 2015, taxpayers would adjust withholdings and declarations beginning in January 2015. This proposal would reduce Total State Revenues in FY 2015 by an estimated $7.8 million.

Officials from the **Department of Revenue (DOR)** provided the following response.

Section 143.011, RSMo.

This provision would reduce the top tax rate by 1/10th of one percent beginning in 2015. The top rate could not be reduced to an amount lower than five percent (5%). The reduction could only occur if net general revenue collected in the previous year exceeded the highest amount collected in any of the previous three years by $100 million. The proposal would also eliminate tax rate brackets as the percentage is reduced below the rate for that bracket.

ASSUMPTION (continued)

Fiscal impact

If net general revenue collected meets the proposed threshold, the Department estimates a reduction in individual income as follows.

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

Administrative impact

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

DOR officials assume Collections and Tax Assistance (CATA) would have additional adjustments to individual income tax returns due to the calculation to reduce taxable income. This, in turn, would increase CATA contacts. CATA would require two additional Tax Collection Technicians I for additional contacts to the delinquent and non-delinquent tax line and one Revenue Processing Technician I for additional contacts to the field offices.

DOR officials assume Withholding Tax would be required to update withholding tables for any changes in the tax rate; however, no additional staff would be required.

ASSUMPTION (continued)

IT impact

DOR officials provided an estimate of $13,759 in IT cost for 504 hours of programming for new tax tables and rates.

Section 143.022, RSMo.

Fiscal impact

This provision would allow for the subtraction of business income from federal adjusted gross income (FAGI). The proposal would allow small corporations or partnerships to apportion the deduction in proportion to individuals' share of ownership of the business.

The proposal would increase the subtraction by 10 percent, once per year, with a maximum subtraction of 50 percent. The proposal would allow an additional subtraction to become effective if net general revenue collected in the previous year exceeded the highest of the three previous fiscal years by $100 million.

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

If net general revenue collections meet the proposed threshold, the Department estimates the following reduction in individual income tax:

2015	$38.4 million
2016	$76.3 million
2017	$114.1 million
2018	$151.9 million
2019	$189.6 million

ASSUMPTION (continued)

Administrative Impact

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

DOR officials assume the additional employees requested under Section 143.011 above would be used to implement this section.

IT impact

DOR officials provided an estimate of $13,759 based on 504 hours of programming to make changes to individual tax programs for the individual business income deduction and $41,278 based on 1,512 hours of programming changes for the small corporation business income deduction.

Section 143.151 RSMo.

DOR officials assume this section would allow Missouri residents with an adjusted gross income of less than $20,000 to claim an additional $1,000 deduction beginning January 1, 2015. It would also allow the same deduction for the taxpayer's spouse if the spouse's income is also below $20,000.

Fiscal impact

Based on the number of qualifying taxpayers in 2011 the Department estimated a reduction of individual income tax of $21.7 million per year.

Administrative Impact

DOR officials assume Collections and Tax Assistance (CATA) would implement this provision with the additional employees requested for Section 143.011.

ASSUMPTION (continued)

IT impact

DOR officials provided an estimate of $9,173 for 336 hours of programming to make changes to personal income tax systems.

Summary of DOR cost estimate

The DOR response included seven additional employees; with benefits, equipment, and expenses, the DOR estimate of cost to implement this proposal totaled $354,805 for FY 2015, $287,253 for FY 2016, and $290,210. DOR officials did not indicate any of the additional employees were required to implement the corporation income tax changes and noted that $9,173 of the total $87,142 in IT cost was required to implement the corporate income tax change.

Oversight assumes this proposal could be implemented with four additional employees and 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.

Oversight notes the changes to personal income tax provisions would be implemented for 2015 and will include the DOR costs for additional employees beginning January 1, 2016 (FY 2016) when the first tax returns for 2015 would be filed. Oversight assumes the IT cost would be applicable to FY 2015 since DOR systems would need to be updated before FY 2016.

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)

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

This proposal would allow any resident with a Missouri adjusted gross income of less than $20,000 an additional deduction of $1,000. It would reduce the top individual income tax rate by one-tenth of one percent each year the previous fiscal year's net general revenue collections exceeds the highest of the three previous fiscal year's net general revenue collections by at least $100 million. The proposed reduction in the individual income tax rate could only happen once per year and the reductions would cease once the top individual tax rate reaches 5%.

Starting in 2015, if the previous fiscal year's net general revenue exceeds the highest of the three previous fiscal year's net general revenue by at least $100 million, this proposal would allow a "business income" deduction for individual income tax filers equal to 10% of "business income". This proposal would increase the "business income" deduction by 10% each year the previous fiscal year's net general revenue collections exceeds the highest of the three previous fiscal year's net general revenue collections by at least $100 million until a maximum "business income" subtraction of 50% is reached.

Individual Income Tax Simulation

This proposal would allow any resident with a Missouri adjusted gross income of less than $20,000 an additional deduction of $1,000. Beginning in 2015, this proposal would reduce the top individual income tax rate by one-tenth of one percent each year until it equals 5% in 2024. It would allow a "business income" subtraction starting at 10% of "business income" in 2015, increasing by 10% each year until it reaches its maximum of 50% of "business income".

ASSUMPTION (continued)

NOTE: The additional deduction for low-income filers is not contingent on the aforementioned growth requirement in net general revenue collections. The reduction in individual tax rates and the "business income" subtraction are contingent upon the growth requirement in net general revenue collections. Since we are unable to predict future net general revenue levels, we are restricted to estimate the fiscal impact of this proposal as a maximum impact estimate. As such, we would assume that the net general revenue growth requirement would be met every year until the reduction in the top individual income tax rate reaches 5% in ten years (2024), and the "business income" subtraction would reach its maximum of 50% in five years (2019).

* The latest 2012 individual income tax data was used as our baseline; the simulation indicated Net Tax Due of $5,109.439 million.

* When the maximum individual tax rate was reduced, and a 10% business income subtraction and an additional exemption for low-income filers were allowed for 2015, Net Tax Due was reduced from $5,109.439 million to $4,963.979 million, a reduction of $145.460 million.

* When the maximum individual tax rate was reduced further, and a 20% business income subtraction and an additional exemption for low-income filers were allowed for 2016, Net Tax Due was reduced from $5,109.439 million to $4,858.348 million, a reduction of $251.091 million.

* When the maximum individual tax rate was reduced further, and a 30% business income subtraction and an additional exemption for low-income filers were allowed for 2017, Net Tax Due was reduced from $5,109.439 million to $4,755.068 million, a reduction of $354.371 million.

* When the maximum individual tax rate was reduced further, and a 40% business income subtraction and an additional exemption for low-income filers were allowed for 2018, Net Tax Due was reduced from $5,109.439 million to $4,654.289 million, a reduction of $455.150 million.

* When the maximum individual tax rate was reduced further, and a 50% business income subtraction and an additional exemption for low-income filers were allowed for 2019, Net Tax Due was reduced from $5,109.439 million to $4,556.153 million, a reduction of $553.286 million.

ASSUMPTION (continued)

* When the maximum individual tax rate was reduced further, and a 50% business income subtraction and an additional exemption for low-income filers were allowed for 2020, Net Tax Due was reduced from $5,109.439 million to $4,480.895 million, a reduction of $628.544 million.

* When the maximum individual tax rate was reduced further, and a 50% business income subtraction and an additional exemption for low-income filers were allowed for 2021, Net Tax Due was reduced from $5,109.439 million to $4,405.792 million, a reduction of $703.647 million.

* When the maximum individual tax rate was reduced further, and a 50% business income subtraction and an additional exemption for low-income filers were allowed for 2022, Net Tax Due was reduced from $5,109.439 million to $4,330.900 million, a reduction of $778.539 million.

* When the maximum individual tax rate was reduced further, and a 50% business income subtraction and an additional exemption for low-income filers were allowed for 2023, Net Tax Due was reduced from $5,109.439 million to $4,256.172 million, a reduction of $853.267 million.

* When the maximum individual tax rate was reduced further, and a 50% business income subtraction and an additional exemption for low-income filers were allowed for 2024, Net Tax Due was reduced from $5,109.439 million to $4,181.654 million, a reduction of $927.785 million.

ASSUMPTION (continued)

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

Calendar Year	Fiscal Year	Corporate Income Tax Revenue	Personal Income Tax Revenue	Total Income Tax Revenue	Estimated Revenue Impact
Baseline		$397,939,000	$5,109,439,000	$5,507,378,000	0
2015	2016	$380,247,000	$4,963,979,000	$5,344,226,000	($163,152,000)
2016	2017	$380,247,000	$4,858,348,000	$5,238,595,000	($268,783,000)
2017	2018	$380,247,000	$4,755,068,000	$5,135,315,000	($372,063,000)
2018	2019	$380,247,000	$4,654,289,000	$5,034,536,000	($472,842,000)
2019	2020	$380,247,000	$4,556,153,000	$4,936,400,000	($570,978,000)
2020	2021	$380,247,000	$4,480,895,000	$4,861,142,000	($646,236,000)
2021	2022	$380,247,000	$4,405,792,000	$4,786,039,000	($721,339,000)
2022	2023	$380,247,000	$4,330,900,000	$4,711,147,000	($796,231,000)
2023	2024	$380,247,000	$4,256,172,000	$4,636,419,000	($870,959,000)
2024	2025	$380,247,000	$4,181,654,000	$4,561,901,000	($945,477,000)

Oversight notes the fiscal impact of this proposal for a year in which the previous year's Net General Revenue collections did not meet the requirement for the contingent tax law changes would be the same as that for the previous year. Tax rates and provisions would not revert to a previous status, but additional changes would not be implemented.

Oversight will use the EPARC estimate of revenue reduction for fiscal note purposes, and will use the indicated amounts in 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 assumes this could reduce revenues a year in advance of the fiscal year indicated in the table. For fiscal note purposes, however, Oversight will indicate the full fiscal impact of the tax changes as shown in the table.

ASSUMPTION (continued)

Section 143.071, RSMo. Corporate Income Tax Changes:

Section 143.071.3 would provide an exemption from income tax for the first twenty-five thousand dollars of taxable corporate income as currently defined.

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 stated that DOR reports 18,155 corporate taxpayers reported taxable income for 2011. If each corporation excludes $25,000, this could Reduce General and Total State Revenues by $28.4 million at the 6.25% tax rate. Because this proposal is effective upon approval, taxpayers would adjust declarations beginning as early as December 2014. This proposal would reduce Total State Revenues in FY 2015 by an estimated $8.5 million.

Oversight assumes some filers would reduce their estimated tax payments in anticipation of a lower tax liability; however, for fiscal note purposes Oversight will indicate the full fiscal impact of the proposal in the fiscal year when tax returns are filed for that year.

Officials from the **Department of Revenue (DOR)** assume this proposal would exempt the first $25,000 of corporate income from taxation.

Fiscal impact

DOR officials stated 18,155 corporate taxpayers reported total taxable income of $5.78 billion for 2011. Based on these figures the Department estimated a reduction of corporate income tax of $28.4 million per year.

Administrative Impact

Corporate Tax would be required to make form changes; as this provision would not be effective until January 1, 2015, Corporate Tax would roll it into the other year-end tax form changes.

IT impact

DOR officials provided an estimate of $9,173 based on 336 hours of programming to make changes to corporate income tax systems.

ASSUMPTION (continued)

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

This proposal would exempt the first $25,000 of corporate income from taxation.

Corporate Income Tax Simulation

EPARC officials noted the latest 2011 corporate income tax data indicates an aggregate liability of $397.939 million, and if the first $25,000 in taxable income is exempted from tax, the aggregate liability for corporate income tax would be reduced to $380.247 million. This corresponds to a reduction in Net General Revenue of $17.692 million.

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.

FISCAL IMPACT - State Government	FY 2015 (10 Mo.)	FY 2016	FY 2017
GENERAL REVENUE FUND			
Cost - DOR			
Salaries	$0	($47,280)	($95,506)
Benefits	$0	($24,115)	($48,713)
Equipment and expense	$0	($32,815)	($4,234)
Total	$0	($104,210)	($148,453)
Personal income tax changes			
Sections 143.011, 143.022, and 143.151			
FTE change - DOR	0	4 FTE	4 FTE
Cost - DOR			
IT cost			
Personal income tax changes			
Sections 143.011, 143.022, and 143.151	($77,969)	$0	$0
Revenue reduction - DOR			
Personal income tax changes			
Sections 143.011, 143.022, and 143.151	$0	($145,460,000)	($145,460,000 to $251,091,000)
(Fully implemented revenue reduction in tenth program year would be $927,785,000.)			
Cost - DOR			
IT cost			
Corporate income exemption			
Section 143.071	($9,173)	$0	$0
Revenue reduction - DOR			
Corporate income exemption			
Section 143.071	$0	($17,692,000)	($17,692,000)
ESTIMATED NET EFFECT ON GENERAL REVENUE FUND *	**($87,142)**	**($163,256,210)**	**($163,300,453 to $268,931,453)**
* Fully implemented revenue reduction in the tenth step would be ($945,477,000)			
Estimated FTE effect on General Revenue Fund	0	4 FTE	4 FTE

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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 small business corporations and owners of small businesses.

FISCAL DESCRIPTION

This proposal would modify the individual income tax rate table. The maximum tax rate on personal income would be reduced by one percent over a period of years. Each reduction to the rate would be one-tenth of a percent and no reduction could go into effect unless net general revenue collected in the previous fiscal year exceeded the highest amount of net general revenue collected in any one of the three previous fiscal years by at least $100 million. Once fully phased in, the top rate of tax on individual income would be five percent.

The proposal would also create an individual income tax deduction for business income and would phase the deduction in over a period of years. Each increase to the deduction amount would be ten percent. Once the deduction is fully phased-in, taxpayers would be allowed a fifty percent deduction. No increase to the deduction could go into effect unless net general revenue collected in the previous fiscal year exceeded the highest amount of net general revenue collected in any of the three fiscal previous years by at least $100 million. Shareholders of small corporations and partners in partnerships would be allowed a proportional deduction based their share of ownership.

The proposal would increase the current personal exemption amount of $2,100 by $1,000 for individuals with a Missouri adjusted gross income of less than $20,000.

The proposal would exempt the first $25,000 of corporate income from taxation.

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

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