COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 4324-18
Bill No.: Perfected SS #3 for SCS for SB Nos. 509 & 496
Subject: Business and Commerce; Taxation and Revenue - Income
Type: Original
Date: March 27, 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 *	$0	$0	$0
Total Estimated Net Effect on General Revenue Fund *	**$0**	**$0**	**$0**

* This proposal would have a fiscal impact beginning in FY 2018. The fully implemented revenue reduction in the fifth year would be $620,987,000.

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 9 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
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

Officials from the **Office of Administration - Division of Budget and Planning (BAP)** assume this proposal would have statewide impact, and would impact the calculation required under Article X, Section 18(e) of the Missouri Constitution.

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

BAP officials also noted this proposal would be effective for 2017, but data from 2011 is the most recent available for analysis, and the actual revenue impact may be substantially different due to the six year difference.

Section 143.011, RSMo. - Individual Income Tax Rate Reductions:

BAP officials noted this proposal would reduce the maximum individual income tax rate from 6.0% to 5.5%, in a series of incremental 0.1% steps. Each reduction would be based on the previous fiscal year's collections, but the first reduction could be implemented as of January 1, 2017. 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. BAP officials assume the fully phased-in proposal would reduce Total State Revenues by an estimated $343.8 million

BAP officials assume if the first reduction occurs for 2017, taxpayers would adjust withholdings and estimated tax declarations beginning in January 2017. Those adjustments could reduce Total State Revenues in FY 2017 by an estimated $24.8 million.

Section 143.011, RSMo. - Individual Income Tax Rate Brackets Indexed for Inflation (SA 1):

BAP officials noted this proposal would adjust the income tax brackets based on the increase in the cost of living. BAP officials assume this means that, instead of $1,000 increments, the increments would be adjusted based on the rate of inflation. For example, if inflation is 1%, the brackets would be based on $1,010 increments.

ASSUMPTION (continued)

BAP officials noted the annual rates of inflation as reported on the United States Department of Commerce, Bureau of Labor Statistics (BLS) website. The highest rate since 1984 was 5.4% and the lowest rate was (0.4) percent.

Applying those figures to 2011 data, BAP officials estimated the impact to Total State Revenues would be a $28.6 million reduction at the 5.4% inflation rate. Similarly, the impact to Total State Revenues would a $5.2 million increase at the (0.4%) inflation rate.

Section 143.022, RSMo. - Individual Income Tax Business Income Subtraction:

BAP officials noted this proposal would phase in a subtraction of business income from taxable income in a series of incremental 5% steps, to a maximum subtraction of 25%. Business Income would include Missouri source net income from the filer's federal Schedule C and Schedule E, Part II. Each reduction would be based on the previous year's collections, but the first deduction could be implemented January 1, 2017.

Based on 2011 data, BAP officials estimated the following impacts, by year:

First Year	($19.2 million)
Second Year	($38.3 million)
Third Year	($57.2 million)
Fourth Year	($76.1 million)
Fifth Year	($94.9 million)

BAP officials assume if the first reduction is implemented for 2017, taxpayers would adjust withholdings and estimated tax declarations and payments beginning in January 2017. Those adjustments could reduce Total State Revenues in FY 2017 by an estimated $6.9 million.

BAP officials noted it is very difficult to identify Missouri source business income from available data, and if the proportion of taxable income from Missouri sources is greater than the estimated amounts for this analysis, then the loss of revenues would be higher.

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

ASSUMPTION (continued)

Officials from the **University of Missouri - Economic and Policy Analysis Research Center (EPARC)** assume this proposal would allow additional individual income tax exemptions for filers with less than $20,000 in Missouri adjust gross income, would reduce individual income tax rates, and would allow a "business income" subtraction for individual income tax filers. In addition, this proposal would increase the individual tax rate brackets by the rate of inflation as measured by changes in the Consumer Price Index.

Specifically, the proposal would allow a resident with Missouri adjusted gross income less than $20,000 an additional deduction of $500. The proposal would reduce the maximum individual income tax rate by one-tenth of one percent each year if the previous fiscal year's net general revenue collections exceeds net general revenue collections in the three previous fiscal years by at least $150 million. The reduction in the individual income tax rate could only happen once per year and, reductions would cease once the maximum individual tax rate reaches 5.5%.

If the previous fiscal year's net general revenue collections exceeds net general revenue collections for the three previous fiscal years by at least $150 million, the proposal would begin implementing a "business income" subtraction for individual income tax filers of 5% of "business income". The proposal would increase this "business income" subtraction by 5% each year, if the previous fiscal year's net general revenue collections exceeds net general revenue collections for the three previous fiscal years by at least $150 million until a maximum "business income" subtraction of 25% is reached.

EPARC officials noted the additional deduction for low-income filers would not be contingent on the net general revenue growth requirement, although the reduction in individual income tax rates and the "business income" subtraction would be contingent on the net general revenue growth requirement. EPARC officials noted they are unable to predict future net general revenue levels.

EPARC officials stated their assumption that the net general revenue growth requirement would be met every year until the reduction in the top individual income tax rate reaches 5.5% in five years (2021), which would also allow the "business income" subtraction to reach its maximum of 25% in five years (2021).

ASSUMPTION (continued)

The EPARC estimate of the rate of inflation follows.

According to the Bureau of Labor Statistics, the average increase in the CPI for All Urban Consumers for the United States over the last three years is approximately 2.3%. EPARC officials stated they used that figure to increase the tax brackets.

The following table indicates the EPARC estimates of revenue reduction, in millions of dollars, for this proposal.

Year	Maximum Tax Rate	Business Income Deduction	Additional Personal Deduction	Increase in Rate Brackets	Estimated Income Tax	Estimated Revenue Reduction
Baseline	6.0%	0	$500	2.3%	$5,109.439	
Year 1	5.9%	5%	$500	2.3%	$4,963.670	$145.679
Year 2	5.8%	10%	$500	2.3%	$4,842.233	$267.206
Year 3	5.7%	15%	$500	2.3%	$4,720.819	$388.620
Year 4	5.6%	20%	$500	2.3%	$4,603.986	$505.453
Year 5	5.5%	25%	$500	2.3%	$4,488.452	$620.987

Oversight notes the changes in this proposal would be effective beginning January 1, 2017, and the first income tax returns would be filed reflecting these changes in January, 2018 (FY 2018). Oversight is aware some filers would reduce their income tax withholding or their estimated tax payments in anticipation of a tax reduction but does not have information as to the impact of those adjustments. For fiscal note purposes, Oversight would include the revenue reductions in the year in which the affected tax returns would be filed; however, the first year this proposal would have an impact would be FY 2018 which is outside the period covered by this fiscal note.

Based on information provided by the Office of Administration - Division of Budget and Planning, between 25% and 50% of the first year impact could affect the year the proposal becomes effective. In this case that would indicate revenue reductions between $36.4 million at 25% and $72.8 million at 50%

ASSUMPTION (continued)

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.

Due to time constraints, **Oversight** has not received a response from the **Department of Revenue (DOR)**; however, since any impact to DOR would be outside the fiscal note period, Oversight would not have included any cost for DOR in this fiscal note.

FISCAL IMPACT - State Government	FY 2015 (10 Mo.)	FY 2016	FY 2017
GENERAL REVENUE FUND			
Revenue reduction - DOR Individual income tax changes *	$0	$0	$0
ESTIMATED NET EFFECT ON GENERAL REVENUE FUND *	**$0**	**$0**	**$0**

* This proposal would have a fiscal impact beginning in FY 2018. The fully implemented revenue reduction in the fifth year would be $620,987,000.

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 small business corporations and owners of small businesses.

FISCAL DESCRIPTION

This proposal would make several changes to current individual income tax provisions.

The proposal would modify the individual income tax rate table. The maximum tax rate on personal income would be reduced by one-half of a percent over a period of years, beginning in 2017. Each rate reduction would be one-tenth of a percent. No reduction could go into effect unless net general revenue collected in the previous fiscal year exceeded net general revenue collected in any of the three preceding fiscal years by at least $150 million. When the rate reductions are fully phased in, the maximum rate of tax on individual income would be five and one-half percent.

The proposal would require the brackets for individual income tax to be adjusted each year, beginning in 2017, for the percentage increase in inflation.

The proposal would create an individual income tax deduction for business income, and would implement it in phases over a period of years, beginning in 2017. Each increase in the deduction amount would be five percent. Once fully phased-in, taxpayers would be allowed to deduct twenty-five percent of their business income. An increase in the deduction percentage could not be implemented unless net general revenue collected in the previous fiscal year exceeded net general revenue collected in any one of the three fiscal years prior to such year by at least $150 million. Shareholders of S corporations and partners in partnerships would be allowed a proportional deduction based their share of ownership.

SAS:LR:OD

FISCAL DESCRIPTION (continued)

The proposal would increase the currently personal exemption amount of $2,100 for individual income taxes by by $500 for individuals with a Missouri adjusted gross income of less than $20,000.

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
University of Missouri
Economic and Policy Analysis Research Center

Not responding:
Department of Revenue

Mickey Wilson, CPA
Director
March 27, 2014

Ross Strope
Assistant Director
March 27, 2014

SAS:LR:OD