COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 4145S.01I
Bill No.: SB 902
Subject: Taxation and Revenue - Income
Type: Original
Date: March 2, 2022

Bill Summary: This proposal increases the amount of the personal income tax cut and the business income deduction in current law.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND				
FUND AFFECTED	FY 2023	FY 2024	FY 2025	Fully Implemented (FY 2029)
General Revenue Fund*	$0	($96,622,939)	($291,628,522)	($512,656,726)
Total Estimated Net Effect on General Revenue	**$0**	**($96,622,939)**	**($291,628,522)**	**($512,656,726)**

*The fiscal impact (reduction in state income taxes) is partially dependent (triggered) by net general revenue collections exceeding any of the previous three fiscal years by at least $150 million. The timeline above assumes meeting this trigger in successive years. The actual fully implemented date could be beyond FY 2029.

ESTIMATED NET EFFECT ON OTHER STATE FUNDS				
FUND AFFECTED	FY 2023	FY 2024	FY 2025	Fully Implemented (FY 2029)
Total Estimated Net Effect on Other State Funds	**$0**	**$0**	**$0**	**$0**

Numbers within parentheses: () indicate costs or losses.

ESTIMATED NET EFFECT ON FEDERAL FUNDS				
FUND AFFECTED	FY 2023	FY 2024	FY 2025	Fully Implemented (FY 2029)
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)				
FUND AFFECTED	FY 2023	FY 2024	FY 2025	Fully Implemented (FY 2029)
Total Estimated Net Effect on FTE	**$0**	**$0**	**$0**	**$0**

☒ Estimated Net Effect (expenditures or reduced revenues) expected to exceed $250,000 in any of the three fiscal years after implementation of the act or at full implementation of the act.

☐ Estimated Net Effect (savings or increased revenues) expected to exceed $250,000 in any of the three fiscal years after implementation of the act or at full implementation of the act.

ESTIMATED NET EFFECT ON LOCAL FUNDS				
FUND AFFECTED	FY 2023	FY 2024	FY 2025	Fully Implemented (FY 2029)
Local Government	**$0**	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

Officials from the **Office of Administration - Budget and Planning (B&P)** state this proposal may reduce TSR by $505.4M annually, once fully implemented.

B&P notes this proposal will impact the calculation under Article X, Section 18.

Section 143.011

Officials from **B&P** state this section would end the current rate reductions, created under SB 509 (2014), after three reductions. B&P notes that there have been three reductions (tax years 2018, 2019, and 2022) so far. This proposal would also prevent the two rate reductions scheduled under SB 153 (2021). However, this proposal would not prevent the 0.1% tax reduction in tax year 2024 scheduled under SB 153 (2021).

Based on current revenue forecasts and average revenue growth, B&P estimates that revenues in FY24 and FY25 will reach the growth trigger requirement for the final two reductions to the top rate of tax under SB 509 (2014). In addition, revenues in FY26 and FY27 will reach the growth trigger requirements for the two top rate reductions under SB 153 (2021). Therefore, the top rate of tax would be reduced by 0.1% in tax years 2025, and 2026 under SB 509 (2014) and tax years 2027 and 2028 under SB 153 (2021).

B&P states Section 143.011.5 would create additional top rate reductions beginning tax year 2023. The top rate of tax may be reduced by 0.2% each year that 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 by at least $150M. The aggregate amount of reductions shall not exceed 0.9%. Table 1 shows the tax rate changes under this proposal.

Table 1: Tax Rates

Tax Year	Current Law	Proposed Reduction	Proposed Top Rate
2018	5.9%	0.0%	5.9%
2019	5.4%	0.0%	5.4%
2020	5.4%	0.0%	5.4%
2021	5.4%	0.0%	5.4%
2022	5.3%	0.0%	5.3%
2023	5.3%	0.0%	5.3%
2024	5.2%	0.2%	5.0%
2025	5.1%	0.2%	4.8%
2026	5.0%	0.2%	4.6%
2027	4.9%	0.2%	4.4%
2028	4.8%	0.0%	4.4%

**Assumes rate reductions scheduled to occur under SB 509 (2014) are triggered for TY25, and TY26. Assumes rate reductions scheduled to occur under SB 153 (2021) are triggered for TY27 and TY28. SB 153 (2021) requires a rate reduction in TY24.*

B&P notes that Section 143.011.5 would allow for a maximum total reduction in the top tax rate of 0.9%. However, each reduction is equal to 0.2%; therefore, only 0.8% in total reductions will occur under this subsection.

B&P further notes that under current law, per SB 153 (2021), a reduction in the top rate of tax shall not occur under subdivision 1 for tax year 2024, even if the growth trigger has been met. Instead, a 0.1% reduction shall occur in tax year 2024 regardless of the growth trigger requirement. This essentially paused the reductions under SB 509 (2014) for one year, while the stand alone reduction occurred. However, this proposal does not contain such moratorium on a growth trigger driven reduction. Based on current forecasts, under this proposal there would be a 0.1% reduction in tax year 2024, per SB 153 (2021) and a 0.2% reduction under this proposal – for a total reduction of 0.3% in tax year 2024.

Officials from the **Department of Revenue (DOR)** state this section is updated to reduce the number of reductions allowed pursuant to subsection 2 of this section (SB509 and SB 153). The amount of reductions allowed pursuant to the aforementioned is currently seven. This proposed legislation would allow that no more than three reductions shall be made under subsection 2 of this section. The Department notes that under current law, two of the reductions have occurred (TY 2018 & TY 2019) and the third is occurring in tax year 2022 which will set the rate at 5.3%.

This section is updated to create a new section 5. The proposed section 5 states that, in addition to the rate reductions under subsection 2 to 4 of this section, beginning with the 2023 calendar year the top rate of tax under subsection 1 of this section may be reduced over a period of years. Each reduction in the top rate of tax shall be by one-fifth of one percent (0.2) and no more than one reduction shall occur in a calendar year. The aggregate amount of reductions made under this subsection shall not exceed nine-tenths of one percent. This will result in 4 reductions being made.

Any reduction in the rate of tax shall only occur if 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 fifty million dollars.

DOR states this proposal says it is to begin with tax year 2023. Based on the current revenue forecast, SB 509 could trigger a reduction in 2024. However, due to a provision in SB 153, it requires that SB 509 not have a reduction in tax year 2024 (regardless of the trigger) and so SB 509 is projected to resume with tax year 2025. This new 0.2% reduction does not contain the same prohibition for triggering a reduction that was in SB 153, so it would be expected to begin in 2024.

Section 143.022
B&P states this section would increase the amount of pass-through business income exempt from individual income tax from 5% increments to 10% increments, beginning with tax year 2023. B&P notes that there have been thee increases in the exemption rate (tax years 2018, 2019, and 2022) so far – for a current business income exemption rate of 15%. B&P notes that under existing law the maximum business income exemption rate is 20%, with one more 5% trigger reliant increase.

Based on current revenue forecasts, B&P estimates that revenues in FY23 will reach the SB 509 (2014) growth trigger requirement for the final 5% increase to the business income exemption. Therefore, the final 5% income exemption increase would occur in tax year 2024. Table 2 shows the pass-through business exemption under this proposal.

Table 2: Pass-through Business Exemption

Tax Year	Current Law	Proposed Increase	Proposed Exemption
2018	5%	0%	5%
2019	10%	0%	10%
2020	10%	0%	10%
2021	10%	0%	10%
2022	15%	0%	15%
2023	15%	0%	15%
2024	20%	10%	25%
2025	20%	10%	35%
2026	20%	10%	45%
2027	20%	10%	45%
2028	20%	0%	45%

**Assumes final pass-through exemption increase scheduled to occur under SB 509 (2014) is triggered for TY24.*

B&P notes that section 143.022.4 would allow for a maximum business income exemption of 50%. B&P notes that the current income exemption rate is 15%. B&P further notes that this proposal would increase the income exemption rate in increments of 10%. Therefore, the business income exemption rate will only reach 45%, even though the stated allowable maximum is 50%.

Using tax year 2019 data, the most recent complete tax year available, and accounting for the changes in individual income tax law created by SB 509 (2014) and SB 153 (2021), B&P estimates that this proposal may reduce TSR and GR by $228.5M in tax year 2024. Once fully implemented in tax year 2028, this proposal could reduce TSR and GR by $505.4M. Table 1 shows the impact from this section by calendar year.

Table 3: Estimated Impact by Tax Year

Tax Year	GR Loss
2023	$0
2024	($228,494,020)
2025	($371,511,151)
2026	($508,234,682)
2027	($615,368,282)
2028	($505,439,898)

**Assumes rate reductions scheduled to occur under SB 509 (2014) are triggered for TY25, and TY26. Assumes rate reductions scheduled to occur under SB 153 (2021) are triggered for TY27 and TY28. SB 153 (2021) requires a rate reduction in TY24.*

***Assumes final pass-through exemption increase scheduled to occur under SB 509 (2014) is triggered for TY24.*

However, because this proposal would take effect January 1, 2023, with the first estimated implementation date of January 1, 2024, individuals will adjust their withholdings and declarations during FY24. Based on actual collections data, B&P estimates that 42% of individual income taxes are paid during fiscal year 1 and 58% are paid during fiscal year 2. Therefore, B&P estimates that this proposal may reduce TSR and GR by $96.0M in FY24. Once fully implemented in FY29, and annually thereafter, this proposal could reduce TSR and GR by $505.4M. Table 2 shows the estimated impact from this section by fiscal year.

Table 4: Estimated Impact by Fiscal Year

Fiscal Year	GR Loss
2023	$0
2024	($95,967,488)
2025	($288,561,215)
2026	($428,935,034)
2027	($553,230,794)
2028	($569,198,361)
2029	*($505,439,898)*

**Assumes rate reductions scheduled to occur under SB 509 (2014) are triggered for TY25, and TY26. Assumes rate reductions scheduled to occur under SB 153 (2021) are triggered for TY27 and TY28. SB 153 (2021) requires a rate reduction in TY24.*

***Assumes final pass-through exemption increase scheduled to occur under SB 509 (2014) is triggered for TY24.*

DOR states this section updates section 4. Subsection 4 is updated to read "for all tax years beginning on or after January 1, 2017 and beginning on or before December 31, 2022", each increase in the percentage shall be by five percent and no more than one increase shall occur in each year.

For all tax years beginning on or after January 1, 2023, each increase in the percentage shall be by ten percent, and no more than one increase shall occur in a calendar year.

The maximum percentage that may be subtracted is increased from twenty to fifty percent of business income.

DOR used its internal Income Tax Model that contains confidential taxpayer data to create the fiscal impact. The Department notes that the individual income tax filing deadline that was scheduled for April 15, 2020 was moved to July 15, 2020. This move in the filing deadline is estimated to prevent the triggering in the next three years of the original SB 509 and would additionally not allow this proposal's reduction requirements to be implemented until tax year 2025. The Department believes that the tax rates, as proposed, would be as follows:

Tax Year	Current Income Tax Rate	Current Business Income Rate	Proposed Income Tax Rate	Proposed Business Income Rate
2018	5.90%	5%	5.90%	5%
2019	5.40%	10%	5.40%	10%
2020	5.40%	10%	5.40%	10%
2021	5.40%	10%	5.40%	10%
2022	5.30%	15%	5.30%	15%
2023	5.30%	15%	5.30%	15%
2024	5.20%	20%	5.00%	25%
2025	5.10%	20%	4.80%	35%
2026	5.00%	20%	4.60%	45%
2027	4.90%	20%	4.40%	45%
2028	4.80%	20%	4.40%	45%
2029	4.80%	20%	4.40%	45%

Tax Year	Amount
2023	$0
2024	($230,054,616)
2025	($376,659,154)
2026	($516,709,044)
2027	($623,089,430)
2028	($513,489,848)

FYI- DOR uses a 42% in the first year and 58% in the second year split when converting from tax (calendar) year to fiscal year. The loss to General Revenue per Fiscal Year is estimated to be:

Fiscal Year	Loss to GR
2023	$0
2024	($96,622,939)
2025	($291,628,522)
2026	($435,480,108)
2027	($561,388,806)
2028	($577,057,605)
2029	($512,656,726)

DOR notes this will require the individual income tax computer system to be modified annually. This is only expected to result in an annual cost of $2,000 for the changes.

Oversight notes that the **Department of Revenue** expects this proposal will require annual computer system upgrades with an estimated cost of $2,000. **Oversight** assumes the DOR is provided with core funding to handle a certain amount of activity each year. Oversight assumes the DOR could absorb the costs related to this proposal. If multiple bills pass which require additional staffing and duties at substantial costs, the DOR could request funding through the appropriation process.

Oversight notes the impact(s) of this proposed legislation have been calculated using internal tax models that contain confidential taxpayer information.

Oversight notes that it does not currently have the resources and/or access to state tax data to produce an independent revenue estimate and is unable to verify the revenue estimates provided by B&P and DOR.

For purposes of this fiscal note, Oversight will report a revenue <u>reduction</u> as estimated by the Missouri Department of Revenue.

FISCAL IMPACT – State Government	FY 2023 (10 Mo.)	FY 2024	FY 2025	Fully Implemented (FY 2029)
GENERAL REVENUE FUND				
Revenue Reduction – Section(s) 143.011 & 143.022 – Individual Income Tax Rate Reduction(s) and Business Income Deduction Increase (p.3-4)	$0	($96,622,939)	($291,628,522)	($512,656,726)
ESTIMATED NET EFFECT ON GENERAL REVENUE FUND	**$0**	**($96,622,939)**	**($291,628,522)**	**($512,656,726)**

FISCAL IMPACT – Local Government	FY 2023 (10 Mo.)	FY 2024	FY 2025	Fully Implemented (FY 2029)
	$0	**$0**	**$0**	**$0**

FISCAL IMPACT – Small Business

Small businesses eligible for a business income deduction could be affected by this proposal.

FISCAL DESCRIPTION

Current law provides for a reduction of 0.7% in the top rate of income tax over a period of years, with each 0.1% cut becoming effective if net general revenue collections meet a certain trigger. This act increases the amount by which the top rate will be reduced. Each year the trigger is met, the top rate will be reduced by 0.2% rather than 0.1%, and the aggregate amount of reductions to be made, including reductions already made and reductions made under this act, shall not exceed 1.2%. (Section 143.011)

Currently, a business income deduction is being phased in over a period of years. Each year that a general revenue growth trigger is met, the deduction amount is increased by 5%. Once fully phased in, individual taxpayers may deduct up to 20% of their business income. This act increases the amount that may be deducted. Each year that the trigger is met, the deduction amount will be increased by 10%. Once fully phased in, individual taxpayers may deduct up to 50% of their business income. (Section 143.022)

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 Administration – Budget & Planning Division
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