COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 3038-02
Bill No.: HJR 56
Subject: Corporations; Property, Real and Personal; Constitutional Amendments; Revenue Department
Type: Original
Date: March 16, 2010

Bill Summary: This resolution proposes a constitutional amendment replacing all taxes on income with an amended sales and use tax.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2011	FY 2012	FY 2013
General Revenue	$0 or ($231,504 to more than $7,231,504)	$0 or ($2,397,353)	$0 or ($1,611,368)
Total Estimated Net Effect on General Revenue Fund	**$0 or ($231,504 to more than $7,231,504)**	**$0 or ($2,397,353)**	**$0 or ($1,611,368)**

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2011	FY 2012	FY 2013
Total Estimated Net Effect on Other State Funds	**$0**	**$0**	**$0**

Numbers within parentheses: ( ) indicate costs or losses.
This fiscal note contains 15 pages.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2011	FY 2012	FY 2013
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2011	FY 2012	FY 2013
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 2011	FY 2012	FY 2013
Local Government	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

In response to a similar proposal from this year (SJR 29), officials from the **Office of Administration - Budget and Planning (BAP)** stated this proposal, upon voter approval, eliminates the taxes listed below beginning January 1, 2012. Lost state revenues are to be replaced by a state sales tax of 5.11%. This sales tax shall apply to any goods or services, except those used as business inputs, or for an investment purpose. Further, the tax shall not apply to intangible personal or used property. Political subdivisions may adjust their sales tax rates so that this proposal is revenue neutral. Taxes eliminated include:

1. Withholding and individual and corporate income taxes.
2. Corporate and bank franchise taxes.
3. All existing state sales and use taxes.
4. All local earnings taxes authorized by state law.

BAP notes that this proposal intends the new sales tax to generate revenues substantially equal to those collected in FY 11. Assuming neutrality is achieved, current projections call for revenues in FY 11 to be well below the levels collected in FY 08, an extraordinary decline which would not have happened except for the recession which began in 2007. This proposal would not allow for state revenues to recover from the unprecedented declines of FYs 09-10. This proposal would make it difficult for the state to provide the level of services currently demanded and those demanded in the future.

The proposal does not directly address motor vehicle sales tax collections, which may be substantially impacted by this proposal. While the sales tax rate on new vehicles would increase, the rate would be zero on used vehicles. Further, significant revenues would be generated from the taxation of motor fuel. BAP defers to MODOT for an estimate of the impacts of these provisions.

The proposal calls for a 5.11% sales tax rate on a much-expanded sales tax base. However, data that is sufficiently detailed to estimate consumer spending while excluding difficult-to-define concepts such as business inputs, rents, and investment is extremely difficult to access. What little literature is available on this topic suggests this rate is likely too low. For instance, the Show-Me Institute has calculated the rate to be 5.79%. Estimates from other groups, such as the Institute for Taxation and Economic Policy, range higher, as much 12% or more. Assuming the 5.79% rate is correct, this proposal would be short of revenue neutrality by nearly 11.74%. Estimating lost individual income, sales tax, and corporate revenues at a very rough $7.1B, this leads to a revenue shortfall of $834M.

ASSUMPTION (continued)

Because of the reduced points of tax collection and the complicated sales tax rebate system, numerous new opportunities for tax fraud may be invented. BAP defers to the DOR for a discussion of such issues, the costs that might be incurred to prevent such fraud, and the considerable administrative costs that will be necessary to transition to the new tax system. Conversely, it is likely that taxpayers that are currently evading income taxes could face higher tax payments as a result of this proposal.

This proposal would effectively eliminate most of the tax credit incentive programs in the state, as well as the Senior Property Tax Credit (Circuit Breaker). This may result in a roughly $120M increase in appropriations for the Homestead Preservation Program, depending on the number of qualifying seniors. BAP defers to the DED and other state agencies that administer tax credits for estimated impacts on those programs.

BAP notes the proposal is not clear as to who bears the responsibility to replace the earnings taxes lost in St. Louis and Kansas City. For this fiscal note, BAP assumes this responsibility will fall to the city governments to adjust their sales tax rates accordingly, but, an argument may be made that this violates the spirit of the Article X, Sections 16-24, of the Missouri Constitution, which prohibits the state from mandating changes in local spending. In this case, the state may be responsible for holding these city governments harmless.

Officials from the **Department of Transportation (MoDOT)** state Article IV of the Constitution remains in place regarding funding for highways and transportation, therefore the new effective 5.11% would apply to the motor vehicle sales and use tax. By eliminating the exemptions currently in place, sales tax on fuel and commercial motor vehicles would be considered state revenue derived from highway users. The effective date of legislation is January 1, 2012. A 2% growth rate for FY12-FY13 is based on FY09 actuals. MoDOT also assumes there would be a loss of funds due to the sales tax exemption for state purchases being removed.

MoDOT states the proposal removes all sales and use taxes and replaces them with a sales tax on NEW products and services. MoDOT's assumption is this proposal would remove the motor vehicle sales and use tax we currently receive from USED cars, which is approximately 50% of our motor vehicle sales and use tax revenue.

Also, MoDOT states the proposal removes all current exemptions of sales tax. Currently there is a sales tax exemption on motor fuel, which is state revenue derived from highway users. Our assumption is that MoDOT would not receive the sales tax charged on motor fuel.

ASSUMPTION (continued)

MoDOT assumes an increase in income to the State Road fund of $104.7 million to Unknown in FY 2012 as well as an increase of $220.8 million in FY 2013. MoDOT also anticipates a corresponding increase to cities and counties of $59.2 million in FY 2012 and $119.8 million in FY 2013 (full year). MoDOT also assumes smaller impacts to the Road Bond Fund ($22.2 million loss in FY 2012 and $44.1 million loss in FY 2013), the Transportation Fund ($0.9 million increase in FY 2013, Department of Transportation Highway Safety Fund ($0.2 million loss in FY 2013, and State Highway and Transportation Department Fund ($2.3 million loss in FY 2013).

Oversight assumes the new sales and use tax would be established in such a way that revenue neutrality would occur for Total State funds as well as revenue within each fund.

Officials from the **Department of Revenue (DOR)** have the following comments and assumptions:

- The FTE impact for fiscal year 2012 is based on a nine-month cycle. Personnel will be required to be fully trained as of January 1, 2012. The Department will need to hire and begin training temporary staff in October 2011.

- This would eliminate the individual income tax for tax years beginning after Jan 1, 2012. This would impact many individuals who have credits that can be carried forward to 2012 and beyond.

- For fiscal year 2011, DOR assumes no additional full time employees would be needed.

- Currently motor fuel is exempt from sales tax if it is subject to the motor fuel tax. Because this exemption is eliminated, all motor fuel would be subject to a sales tax in addition to the motor fuel tax unless used in a trade or business.

- This legislation will have a significantly larger impact on DOR if we are required to collect the tax from the person consuming, using or storing the tangible personal property or taxable service.

- Section 4(d)2. specifies, "… in furtherance of other bona fide business purposes." This makes everything from "for resale" to "services, or" superfluous

ASSUMPTION (continued)

Personal Tax:

- For FY 11 - Personal Tax will retain 100% of existing staff to continue the processing and collection duties of individual income tax.
- For FY 12 - Personal Tax will retain 100% of existing staff to continue the processing and collection duties of individual income tax.
- For FY 13 - Personal Tax will retain 100% of existing staff for the first six months to continue the processing and collection duties of individual income tax (July 2012 through December 2012). For the last six months of FY13 (January 2013 - June 2013), Personal Tax will retain 81% of existing staff (108 FTE out of 134 FTE) for processing and collection duties of individual income tax. Personal Tax expects late filing and amended returns for Fiduciary Income Tax and Property Tax Credits.
- Personal Tax will move employees to replace the temporary employees hired in business tax on a one-for-one basis.

Collections and Tax Assistance (CATA)

- The registration area would see an impact because including all services as a taxable product would greatly expand the types of businesses that will need to register for sales/use tax.
- Presuming the number of businesses required to register for sales tax doubles, CATA could see the following impact:
- FY11 - No impact
- FY12 - Based on the presumption of doubling the number of businesses, for registration, contacts, collection effort -CATA will need an additional 88 temporary employees (CATA's FY09 sales use tax and registration FTE impact was 44) Training will begin in October of 2011.
- FY13 - Anticipate CATA could reduce 15% of the temporary employees due to a decline in income, withholding and corporate tax accounts (this reduction can be seen in the 2013 column of the attached spreadsheet).

Sales, Excise and Business Tax:

- The following impact is based upon the assumption that the workload for sales/use tax will double because of the additional filers. Based upon FY09 program costs, which include processing, correspondence, error correction, refunds, etc., Business tax will need an additional 97 temporary employees for sales/use tax.

ASSUMPTION (continued)

- DOR assumes that although the new sales tax would go into effect January 1, 2012, current staff responsible for corporate tax, withholding tax and personal tax will not be available for reallocation until the last half of FY13, and even then, it may be only a fraction of the employees. Therefore, temporary staff will be needed until the current staff can be reallocated.
    - FY 11 - No impact
    - FY 12 - Business tax will need 97 temporary employees. Training will begin in October of 2011. These would be temporary employees who receive no benefits.
    - FY 13 - For the first half of the year Business tax will need the 97 temporary employees and for the second half Business tax will need 73 temporary employees. The reduction for the second half of FY13 is based upon the assumption that 25% of the permanent staff will now be available for reallocation - Rather than hire new temporary staff, which would require training the new staff; it would be more beneficial to retain the temporary employees. The employees would then be eligible for benefits.

- If the number of new filers should more than double, then the amount of additional resources will increase proportionately

Corporate/Withholding Tax:
- For FY 11 - Corporate/Withholding tax will retain 100% of existing staff to continue the processing and collection duties of withholding and corporate tax.
- For FY 12 - Corporate/Withholding tax will retain 100% of existing staff to continue the processing and collection duties of withholding and corporate tax.
- For FY 13 - Corporate/Withholding tax will retain 33% of existing staff in the Withholding Tax Section (4 out of 12 FTE) and 87% of existing staff in the Corporate Tax Section (34 out of 39 FTE) to continue the processing and collection duties of withholding and corporate tax. The remaining FTE will be moved to the Sales Tax area to replace temporary employees hired in business tax area on a one-to-one basis.

In summary, DOR assumes the need for 185 Temporary Tax employees (88 in CATA and 97 in Business) in fiscal years 2012 and 2013. State programming expenses for FY 2011 are estimated to be $231,504 (8,736 FTE hours to make updates to the individual income tax processing system (MINITS), the corporate income tax processing system (COINS), the sales tax processing system (MITS), and the withholding tax processing system.

ASSUMPTION (continued)

DOR assumes the cost for the temporary employees in FY 2012 and FY 2013 to be $2.3 million and $2.2 million respectively.

Also, DOR states that in FY09, the Field Compliance Bureau conducted 1,800 sales and use tax audits. In order to conduct 3,600 sales and use tax audits, it would be necessary to double our audit enforcement staff. To double our current audit staff, we would need to add 161 instate and out of state personnel. DOR assumes the cost of these additional FTE would total $11,480,896 in FY 2012 and $10,912,187 in FY 2013.

Oversight assumes the Field Compliance Bureau would be able to use some of the existing staff that currently conducts income tax or franchise tax audits to conduct new sales and use tax audits. Also, with the start date of the new sales tax being January 1, 2012, Oversight assumes the sales and use tax audits would not be conducted prior to fiscal year 2014. Therefore, in the Field Compliance Bureau, Oversight assumes the fiscal impact of the additional FTE would be outside the scope of this fiscal note.

Oversight will also assume DOR will pay the employer FICA tax only on the temporary employees.

Officials from the **Office of Secretary of State (SOS)** assume there would be costs due to additional publishing duties related to the Department of Revenue's authority to promulgate rules, regulations, and forms. SOS estimates the division could require approximately 290 new pages of regulations in the Code of State Regulations at a cost of $27.00 per page, and 435 new pages in the Missouri Register at a cost of $23.00 per page. Costs due to this proposal are estimated to be $17,835, however, the actual fiscal impact would be dependent upon the actual rule-making authority and may be more or less. Financial impact in subsequent fiscal years would depend entirely on the number, length, and frequency of the rules filed, amended, rescinded, or withdrawn.

Oversight assumes the SOS could absorb the costs of printing and distributing regulations related to this proposal. If multiple bills pass which require the printing and distribution of regulations at substantial costs, the SOS could request funding through the appropriation process. Any decisions to raise fees to defray costs would likely be made in subsequent fiscal years.

Officials at the **Office of the Secretary of State** (**SOS**) also assume unless a special election is called for the purpose, Joint Resolutions are submitted to a vote of the people at the next general election. If a special election is called to submit a Joint Resolution to a vote of the people, section 115.063.2 RSMo requires the state to pay the costs. Article III section 52(b) of the

ASSUMPTION (continued)

Missouri Constitution authorizes the general assembly to order a special election for measures referred to the people and Article XII section 2(b) authorizes the governor to call a special election to submit constitutional amendments to a vote of the people.

The SOS is required to pay for publishing in local newspapers the full text of each statewide ballot measure as directed by Article I, Section 26, 27, 28 of the Missouri Constitution and Section 116.230-116.290, RSMo. The Secretary of State's office is provided with core funding to handle a certain amount of normal activity resulting from each year's legislative session. Funding for this item is adjusted each year depending upon the election cycle with \$1.3 million historically appropriated in odd numbered fiscal years and \$100,000 appropriated in even numbered fiscal years to meet these requirements. The appropriation has historically been an estimated appropriation because the final cost is dependent upon the number of ballot measures approved by the General Assembly and the initiative petitions certified for the ballot. In FY 2009, at the August and November elections, there were 5 statewide Constitutional Amendments or ballot propositions that cost \$1.35 million to publish (an average of \$270,000 per issue). Therefore, the Secretary of State's office assumes, for the purposes of this fiscal note, that it should have the full appropriation authority it needs to meet the publishing requirements. However, because these requirements are mandatory, we reserve the right to request funding to meet the cost of our publishing requirements if the Governor and the General Assembly change the amount or eliminate the estimated nature of our appropriation.

Oversight has reflected in this fiscal note, the state potentially reimbursing local political subdivisions the cost of having this joint resolution voted on during a special election in fiscal year 2011. This reflects the decision made by the Joint Committee on Legislative Research, that the cost of the elections should be shown in the fiscal note. The next scheduled general election is in November 2010 (FY 2011). It is assumed the subject within this proposal could be on that ballot; however, it could also be on a special election called for by the Governor. Therefore, Oversight will reflect a potential election cost reimbursement to local political subdivisions in FY 2011.

To estimate the expense the state would incur for reimbursing local political subdivisions for a special election, Oversight requested expense estimates from all election authorities for an election. Eighty-six out of the one hundred fifteen election authorities responded to Oversight's request. From these respondents; the total election expense that would have to be reimbursed by the state government is over \$7 million. Therefore, Oversight will reflect a potential cost borne by the state in FY 2011 of over \$7 million for reimbursement to the local political subdivisions. Oversight assumes the Governor could call for a special election to be held prior to November, 2010 regarding this joint resolution; however, if a special election is not called, the subject will

ASSUMPTION (continued)

be voted on at the general election in November, 2010.

In response to a similar proposal from this year (SJR 29), officials from the **Department of Higher Education** stated although this bill could have a significant fiscal impact on the state's general revenue, it's specific impact on the DHE is unknown at this time.

Officials from the **University of Missouri - Economic and Policy Analysis Research Center (EPARC)** state as written, the bill is constructed to be revenue-neutral. "(I)f the revenue lost as a result of the prohibition on the taxation of income is greater than or less than the revenue received" from the replacement state sales tax, the General Assembly may make one adjustment to the sales tax rate "to ensure that the amount of revenue received (under the proposed state sales tax) is substantially equal to the amount of revenue that would have been generated by the taxes repealed." As such, there would be no revenue impact associated with this bill.

Officials from the **Department of Elementary and Secondary Education (DESE)** state the proposal replaces income tax with a sales and use tax. The language states that the revenue will not be adversely affected. Based on this assumption, the state school foundation formula would not be negatively impacted. However, the impact of an increased sales tax on purchases within the state is unknown. We defer to the Department of Revenue in that regard.

Officials from the **State Tax Commission** assume the proposal would not fiscally impact their agency.

In response to a similar proposal from this year (SJR 29), officials from **Legislative Research** assumed the proposal will not create a fiscal impact; however, additional compensatory time may be needed for staff attorneys if the proposed clean-up bill is done during regular session.

Officials from **Cass County** assume this will not impact current sales taxes that exist in local governments. It is assumed that this proposal just replaces the state income tax with a state-wide sales tax (as defined). Thus, if Cass County is assuming correctly, and its sources of sales tax revenue remain in place, there is no fiscal impact on the county budget.

Officials from **St. Louis County** state they collect $2.6 million in franchise fees, mostly from cable television. If this is included, St. Louis County could be impacted if the sales tax generates less than this amount. The total franchise tax is 5%, so if the sales tax rate is set at 5.11%, St. Louis County would not be impacted.

ASSUMPTION (continued)

Officials from the **City of Kansas City** state the legislation will have a negative fiscal impact on them. The legislation is vague on how local governments would replace their earnings taxes. Kansas City currently receives over $200 million annually from its earnings tax. Therefore, this legislation would cause Kansas City to lose over $200 million annually.

Officials from the cities of **Cape Girardeau**, **Independence**, **Kirksville**, **Poplar Bluff** as well as the counties of **Cape Girardeau**, **Franklin**, and **Jasper** did not respond to our request for fiscal impact.

Officials from the **Office of the State Treasurer** and the **Office of the Governor** assume the proposal would not fiscally impact their agency.

Officials from the **Office of the Attorney General** assume that any potential costs arising from this proposal can be absorbed with existing resources.

Officials from the **Department of Natural Resources (DNR)** state their Parks and Soils sales tax funds are derived from one-tenth of one percent sales and use tax pursuant to Section 47(a) of the Missouri Constitution. It appears that the intent of Section 4(d).4. is to allow for the conservation sales tax and the soil and parks sales tax to be recalculated to produce substantially the same amount of revenue. If that is the intent, then for purposes of this fiscal note, the department would not anticipate a direct fiscal impact from this provision.

If that is not the intent of this proposal and DNR's parks and soils sales tax is eliminated as a result of this proposal, then there would be a significant fiscal impact to the department. Funding would have to be sought to replace the monies currently collected from the department's sales and use tax pursuant to Section 47(a) of the Missouri Constitution. The department assumes the Department of Revenue would be better able to estimate the potential fiscal impact.

This proposal would also appear to eliminate all sales tax exemptions. Currently, the State of Missouri is a tax-exempt entity. If this department is required as a result of this proposal to pay the newly created 5.11% sales tax on the purchase of all goods and services, then there would be a significant unknown fiscal impact to the department. Each state agency's operating budget would increase substantially. The department assumes the Office of Administration would be better able to estimate the amount of fiscal impact from this provision for each department.

ASSUMPTION (continued)

Oversight will range the fiscal impact to the Department of Revenue from $0 (resolution is not passed by public vote) to their estimate. Oversight also assumes the proposal would be implemented in such a way that sales tax revenues to the state as well as local political subdivisions would be equivalent to the lost revenue from income tax, local earning tax, existing sales tax, franchise tax, and bank franchise tax.

Oversight assumes this proposal will not change Total State Revenues.

FISCAL IMPACT - State Government	FY 2011 (10 Mo.)	FY 2012	FY 2013
GENERAL REVENUE			
Costs - Department of Revenue			
Temporary Personnel (185 temps)	$0	$0 or ($1,148,159)	$0 or ($1,360,355)
Fringe Benefits for Temps (FICA)	$0	$0 or ($87,834)	$0 or ($104,067)
Expense and Equipment	$0	$0 or ($1,161,360)	$0 or ($146,946)
Programming Changes	$0 or ($231,504)	$0	.$0
Total Costs - DOR	$0 or ($231,504)	$0 or ($2,397,353)	$0 or ($1,611,368)
Expense - reimbursement of local political subdivisions for special election costs	$0 or (More than $7,000,000)	$0	$0
ESTIMATED NET EFFECT TO THE GENERAL REVENUE FUND	**$0 or ($231,504 to more than $7,231,504)**	**$0 or ($2,397,353)**	**$0 or ($1,611,368)**

FISCAL IMPACT - Local Government	FY 2011 (10 Mo.)	FY 2012	FY 2013
LOCAL POLITICAL SUBDIVISIONS			
Income - cost reimbursement from the State for special election	$0 or More than $7,000,000	$0	$0
Expense - cost for special election	$0 or (More than $7,000,000)	$0	$0
ESTIMATED NET EFFECT TO LOCAL POLITICAL SUBDIVISIONS	**$0**	**$0**	**$0**

FISCAL IMPACT - Small Business

This proposal would have a direct fiscal impact on small businesses that pay income tax, corporate franchise tax, bank franchise tax and/or earnings tax. Also, small businesses may now need to collect and remit a sales tax.

FISCAL DESCRIPTION

Upon voter approval, this proposed constitutional amendment replaces the state individual and corporate income tax and state sales and use tax with a fair sales tax of 5.11% on retail sales of new tangible personal property and taxable services beginning January 1, 2012. The General Assembly, with or without a recommendation from the Tax Adjustment Commission which is established in the amendment, can make one rate adjustment to be effective no later than July 1, 2012, to adjust the amount of revenue received to make the tax revenue-neutral and to provide continued funding for programs. A component part or ingredient of a new tangible personal property to be sold at retail, federal government purchases, and business-to-business transactions including agriculture will be exempt from the new sales tax while all other exemptions and tax credits will be eliminated. Any new exemptions will require a two-thirds affirmative vote by the General Assembly and approval by the Governor. The conservation sales tax, the soil and parks sales tax, and local sales taxes will be recalculated to produce substantially the same amount of revenue. Each qualified family will receive a sales tax rebate based on the federal poverty level guidelines to offset the sales tax on basic necessities.

RS:LR:OD (12/02)

FISCAL DESCRIPTION (continued)

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 and Planning
Department of Transportation
Department of Revenue
Office of the Secretary of State
Department of Higher Education
University of Missouri - Economic and Policy Analysis Research Center
Department of Elementary and Secondary Education
State Tax Commission
Legislative Research
Office of the State Treasurer
Office of the Governor
Office of the Attorney General
Department of Natural Resources
City of Kansas City
St. Louis County
Cass County

NOT RESPONDING:

Cape Girardeau
Independence
Kirksville
Poplar Bluff
Cape Girardeau County
Franklin County
Jasper County

Mickey Wilson

Mickey Wilson, CPA
Director

RS:LR:OD (12/02)

March 16, 2010