COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

# FISCAL NOTE

L.R. No.: 0206-01
Bill No.: SB 11
Subject: Business and Commerce; Taxation and Revenue-Income
Type: Original
Date: January 11, 2013

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Bill Summary: This proposal would change certain individual and corporate income tax provisions.

## FISCAL SUMMARY

| ESTIMATED NET EFFECT ON GENERAL REVENUE FUND | | | |
|---|---|---|---|
| FUND AFFECTED | FY 2014 | FY 2015 | FY 2016 |
| General Revenue | ($68,020,240) | ($134,815,783) | ($200,605,417) |
| | | | |
| **Total Estimated Net Effect on General Revenue Fund** | **($68,020,240)** | **($134,815,783)** | **($200,605,417)** |

| ESTIMATED NET EFFECT ON OTHER STATE FUNDS | | | |
|---|---|---|---|
| FUND AFFECTED | FY 2014 | FY 2015 | FY 2016 |
| | | | |
| | | | |
| **Total Estimated Net Effect on Other State Funds** | **$0** | **$0** | **$0** |

Numbers within parentheses: ( ) indicate costs or losses.
This fiscal note contains 12 pages.

| ESTIMATED NET EFFECT ON FEDERAL FUNDS | | | |
|---|---|---|---|
| FUND AFFECTED | FY 2014 | FY 2015 | FY 2016 |
| | | | |
| | | | |
| **Total Estimated Net Effect on All Federal Funds** | **$0** | **$0** | **$0** |

| ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE) | | | |
|---|---|---|---|
| FUND AFFECTED | FY 2014 | FY 2015 | FY 2016 |
| General Revenue | 4 | 4 | 4 |
| | | | |
| **Total Estimated Net Effect on FTE** | **4** | **4** | **4** |

☒ 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 2014 | FY 2015 | FY 2016 |
| **Local Government** | **$0** | **$0** | **$0** |

## FISCAL ANALYSIS

ASSUMPTION

Officials from the **Office of the Secretary of State** assume this proposal would have no fiscal impact to their organization.

In response to similar proposals, officials from the **Joint Committee on Administrative Rules** assumed that this proposal would not have a fiscal impact to their organization in excess of existing resources.

Personal Business Income Tax Deduction: Section 143.013, RSMo

Officials from the **Department of Revenue (DOR)** noted that the proposed change to this section would allow an individual to subtract from federal adjusted gross income the amounts of business income as defined to the extent included in federal adjusted gross income when determining the individual's Missouri adjusted gross income. The deduction would be phased in as follows.

From January 1, 2013 until January 1, 2014, 10% of business income;
from January 1, 2014 until January 1, 2015, 20% of business income;
from January 1, 2015 to January 1, 2016, 30% of business income;
from January 1, 2016 to January 1, 2017, 40% of business income; and
from January 1, 2017 and thereafter, 50% of business income.

Fiscal impact

DOR officials noted that for calendar year 2011, Missouri individual income tax filers reported $11.7 billion in business income on Schedule C, Schedule D, Schedule E, and Schedule F for their federal 1040 forms. DOR officials included the total reported income in the calculation although some portion of the $11.7 billion reported income could have been earned outside the state of Missouri and thus, not have been taxable in Missouri. On the other hand, the $11.7 billion does not include Missouri business income on a federal return filed by an individual that did not have a Missouri address.

ASSUMPTION (continued)

Based on that $11.7 billion in business income, and at the current tax rate of 6 percent, the Department estimates the following reduction in individual income tax:

| | |
|---|---|
| 2013 | $70.2 million |
| 2014 | $140.4 million |
| 2015 | $210.6 million |
| 2016 | $280.8 million |
| 2017 | $351.0 million |

Officials from the **Office of Administration, Division of Budget and Planning (BAP)** assume this proposal would phase in a deduction of business income from individual income tax, increasing from 10% in tax year 2013, to 20% in tax year 2014, to 30% in tax year 2015; to 40% in tax year 2016; and 50% in each year thereafter. Business Income would be defined as income greater than zero from the taxpayer's trade or business, and would include income from tangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

BAP officials do not have data that specifically identifies taxable business income as defined in the proposal. The federal Internal Revenue Service (IRS), in its Statistics of Income estimates for Missouri, provided the data in the chart below for 2010. BAP officials also note it is possible that Capital Gains or Dividend Income, as well as additional forms of income, could be included in business income in certain cases. Therefore, BAP assumes that business income would exceed $10.5 billion per year.

ASSUMPTION (continued)

At the highest (6%) marginal tax rate, the revenue reduction from the exclusion of 50% of business income from personal income tax could exceed $315 million, notwithstanding any inflationary growth.

| | |
|---|---|
| Adjusted Gross Income ($ millions) | $135,415 |
| | |
| Business Income | $3,960 |
| Partnership Income | $6,565 |
| Sub-total | $10,525 |
| | |
| Percent of Adjusted Gross Income | 7.7% |
| | |
| Ordinary Dividends | $3,295 |
| Qualified Dividend | $2,680 |
| Net Capital Gain | $3,803 |
| Subtotal | $9,777 |
| | |
| Percent of Adjusted Gross Income | 7.2% |
| | |
| Total | $20,302 |
| | |
| Total Percent of Adjusted Gross Income | 15.0% |

**Oversight** notes that the $10.5 billion in business income referred to in the BAP comment includes only the Business Income and Partnership Income in the chart above. If the Ordinary Dividends, Qualified Dividends, and Net Capital Gains in the chart above and referred to in the BAP response would be considered business income subject to deduction under this proposal, the total business income subject to deduction would be $20,302 or nearly twice as much as the initial BAP estimate of $10.5 billion, and the revenue reduction resulting from this provision would also be nearly twice as much.

Officials from the **University of Missouri, Economic and Policy Analysis Research Center (EPARC)** noted that this proposal would provide a “Business Income” subtraction.

ASSUMPTION (continued)

EPARC officials used reported federal self - employment income to estimate “Business Income” for this proposal, and determined that self - employment income by dividing each filer’s self - employment tax by their applicable tax rate. Using that methodology, EPARC estimated aggregate positive “business income” at $7,229,010,965 for 312,226 Missouri filers. That amount of income was then gradually subtracted from filers’ federal AGI to arrive at their simulated Missouri AGI; a 10% subtraction for 2013, a 20% subtraction for 2014, a 30% subtraction for 2015, a 40% subtraction for 2016 and a 50% subtraction for 2017.

The impact of the personal income tax provisions is shown in this chart - all amounts are in millions of dollars.

| Year | Individual Business Income Reduction | Individual Income Tax Revenue | Individual Income Tax Revenue Reduction |
|---|---|---|---|
| Baseline | 0% | $4,693.390 | $0.000 |
| 2013 | 10% | $4,663.934 | $29.456 |
| 2014 | 20% | $4,635.522 | $57.868 |
| 2015 | 30% | $4,608.141 | $85.249 |
| 2016 | 40% | $4,582.100 | $111.290 |
| 2017 | 50% | $4,557.582 | $135.808 |

**Oversight** will use the EPARC estimates in this fiscal note, and since revenues from income taxes are normally realized when returns are filed in the following state fiscal year, Oversight will include the fiscal impact for the provisions for 2013 in FY 2014, the provisions for 2014 provisions in FY 2015, and the provisions for 2015 provisions in FY 2016.

**Oversight** notes that there could be some reduction in estimated tax payments due to expected tax reductions if legislation is passed, but considers that potential impact to be negligible due to the timing of the legislative session and the uncertainty of final action by the Governor.

ASSUMPTION (continued)

Corporate Income Tax Rate: Section 143.071, RSMo

Officials from the **Department of Revenue (DOR)** noted that the proposed change to this section would change corporate income tax rates as follows.

Before January 1, 2013, 6.250% of taxable income;
from January 1, 2013 to January 1, 2014, 5.625% of taxable income;
from January 1, 2014 to January 1, 2015, 5.000% of taxable income;
from January 1, 2015 to January 1, 2016, 4.375% of taxable income;
and from January 1, 2017 and thereafter, 3.125% of taxable income.

DOR officials noted that Missouri corporate taxpayers reported $5.6 billion in taxable income and $350 million in tax for 2010. Based on that estimated tax of $350 million, the Department calculated the following reduction in corporate income tax.

| | |
|---|---|
| 2013 | $34 million |
| 2014 | $70 million |
| 2015 | $105 million |
| 2016 | $140 million |
| 2017 | $175 million |

Officials from the **Office of Administration, Division of Budget and Planning (BAP)** noted that this proposal would reduce the corporate tax rate over three years, from 6.25% to 3.125%. In FY 2012, $275.6 million in net corporate taxes was received. Notwithstanding any inflationary growth, this proposal would reduce general and total state revenues as in the chart below. Numbers are in millions of dollars.

ASSUMPTION (continued)

| Year | Tax Rate | Revenue | Revenue Reduction |
|---|---|---|---|
| FY 2012 (Baseline) | 6.25% | $275.6 | $0.0 |
| FY 2014 | 5.625% | $248.0 | $57.6 |
| FY 2015 | 5.000% | $220.5 | $55.1 |
| FY 2016 | 4.375% | $192.9 | $82.7 |
| FY 2017 | 3.750% | $165.4 | $110.2 |
| FY 2018 | 3.125% | $137.8 | $137.8 |

Officials from the **University of Missouri, Economic and Policy Analysis Research Center (EPARC)** noted that this proposal would gradually reduce the corporate income tax rate from 6.25% in 2012 to 5.625% in 2013, to 5% in 2014, and to 4.375% in 2015, to 3.75% in 2016, and finally to 3.125% in 2017. The latest 2010 corporate income tax data indicates an aggregate liability of $383.905 million. The impact of the corporate tax rate changes is shown in this chart. All amounts are in millions of dollars.

| Year | Corporate Income Tax Rate | Corporate Income Tax Revenue | Corporate Income Tax Revenue Reduction |
|---|---|---|---|
| Baseline | 6.25% | $383.905 | $0.000 |
| 2013 | 5.25% | $345.514 | $38.391 |
| 2014 | 4.25% | $307.124 | $76.781 |
| 2015 | 3.25% | $268.733 | $115.172 |
| 2016 | 3.25% | $230.342 | $153.563 |
| 2017 | 3.25% | $191.952 | $191.953 |

ASSUMPTION (continued)

**Oversight** will use the EPARC estimates in this fiscal note, and since revenues from income taxes are normally realized when returns are filed in the following state fiscal year, Oversight will include the fiscal impact for the changes in 2013 provisions in FY 2014, the changes in 2014 provisions in FY 2015, and the changes in 2015 provisions in FY 2016.

**Oversight** notes that there could be some reduction in estimated tax payments due to expected tax reductions if legislation is passed, but considers that potential impact to be negligible due to the timing of the legislative session and uncertainty of final action by the Governor.

Administrative impact

Officials from the **Department of Revenue (DOR)** assume the Department would need to make form changes, and the Department and ITSD-DOR would need to make programming changes to various tax systems.

In order to implement this proposal, DOR officials assumed Personal Tax would require two additional Temporary Tax Employees for key entry, one additional Revenue Processing Technician I (Range 10, Step L) per 19,000 additional errors, and one additional Revenue Processing Technician I (Range 10, Step L) per 2,400 pieces of correspondence.

Corporate tax would require one additional Revenue Processing Technician I (Range 10, Step L) per 7,800 additional errors generated, with CARES equipment and license, and one additional Revenue Processing Technician I (Range 10, Step L) per 2,600 additional pieces of correspondence generated, with CARES equipment and license.

Collections and Tax Assistance (CATA) would require one additional Tax Collection Technician I (Range 10, Step L) for every additional 15,000 contacts annually to the non-delinquent tax line, including one CARES phone and agent license, one additional Tax Collection Technician I (Range 10, Step L) for every additional 15,000 contacts annually to the delinquent tax line, including one CARES phone and agent license, and one additional Revenue Processing Technician I (Range 10, Step L) for every additional 4,800 contacts annually to the field offices with a CARES phone and agent license.

The DOR estimate of the cost to implement this proposal included two additional temporary tax employees and seven additional FTE. The estimate, including salaries, benefits, equipment, and expense, totaled $301,123 for FY 2014, $302,032 for FY 2015, and $305,199 for FY 2016.

ASSUMPTION (continued)

**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 for the first fiscal year could be reduced by roughly $6,000 per new employee.

**Oversight** also assumes that a substantial majority of individual tax filers would use tax preparation software or have their return prepared by a paid preparer, and virtually all corporate filers would have returns prepared by a paid preparer or corporate officer. Accordingly, the number of calculation errors would be significantly reduced over previous years and the DOR estimate of additional FTE may be overstated. Oversight assumes this proposal could be implemented with four additional FTE.

**Oversight** 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 the 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.

IT Impact

DOR officials provided an estimate of the IT cost to implement this proposal of $21,748 based on 804 hours of programming to make changes to DOR systems.

**Oversight** assumes OA - ITSD (DOR) is provided with core funding to handle a certain amount of activity each year. Oversight assumes OA - ITSD (DOR) could absorb the costs related to this proposal. If multiple bills pass which require additional staffing and duties at substantial costs, OA - ITSD (DOR) could request funding through the appropriation process.

| FISCAL IMPACT - State Government | FY 2014 (10 Mo.) | FY 2015 | FY 2016 |
|---|---|---|---|
| **GENERAL REVENUE FUND** | | | |
| Cost - Department of Revenue | | | |
| Salaries - 4 FTE | ($77,120) | ($92,544) | ($109,383) |
| Temporary employees | ($13,000) | ($15,756) | ($15,914) |
| Benefits | ($45,731) | ($54,957) | ($55,506) |
| Equipment and expense | ($37,389) | ($3,526) | ($3,614) |
| Total | ($173,240) | ($166,783) | ($184,417) |
| Revenue reduction | | | |
| Personal income tax | ($29,456,000) | ($57,868,000) | ($85,249,000) |
| Corporate income tax | ($38,391,000) | ($76,781,000) | ($115,172,000) |
| Total | ($67,847,000) | ($134,649,000) | ($200,421,000) |
| **ESTIMATED NET EFFECT ON GENERAL REVENUE FUND** | **($68,020,240)** | **($134,815,783)** | **($200,605,417)** |
| Estimated Net FTE Effect on General Revenue Fund | 4 | 4 | 4 |

| FISCAL IMPACT - Local Government | FY 2014 (10 Mo.) | FY 2015 | FY 2016 |
|---|---|---|---|
| | **$0** | **$0** | **$0** |

FISCAL IMPACT - Small Business

This proposal would have a direct fiscal impact to any small business which is currently subject to income tax.

FISCAL DESCRIPTION

This proposal would reduce the tax on business income over a five-year period.

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
Office of Administration
    Division of Budget and Planning
Department of Revenue
University of Missouri
    Economic and Policy Analysis Research Center

Ross Strope
Acting Director
January 11, 2013

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