COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 4669-07
Bill No.: SCS for HCS for HB 1295
Subject: Taxation and Revenue - Income
Type: Original
Date: April 14, 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 *	(More than $65,302)	($113,912,210)	($113,965,453 to $226,062,453)
Total Estimated Net Effect on General Revenue Fund *	**(More than $65,302)**	**($113,912,210)**	**($113,965,453 to $226,062,453)**

* Fully implemented revenue reduction in the fifth year would be $553,765,000.

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 17 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

Section 143.022, RSMo - Personal Income Tax Changes:

Changes to this provision 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 fifty 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.

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 assumed the proposal would impact the calculation under Article X, Section 18(e).

This provision would allow an exclusion for up to 50% of business income from taxable income, in a series of incremental 10% steps. The provision 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, this provision would reduce Total State Revenues by an estimated $189.1 million.

BAP officicals noted 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.

ASSUMPTION (continued)

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.

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

Fiscal impact

This provision would allow for the subtraction of business income from federal adjusted gross income (FAGI). This provision 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. This provision 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 $150 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	$38.6 million
2016	$76.7 million
2017	$114.8 million
2018	$152.8 million
2019	$190.7 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 Collections & Tax Assistance (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. Each technician would require CARES equipment and license.

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.

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

Starting in 2015, if the previous fiscal year's net general revenue collections exceeds any of the three previous fiscal year's net general revenue by at least $150 million, this bill would begin allowing a "business income" subtraction for individual income tax filers equal to 10% of "business income". This legislation would increase this "business income" subtraction by 10% each year the previous fiscal year's net general revenue collections exceeds any of the three previous fiscal year's net general revenue by at least $150 million until a maximum "business income" subtraction of 50% is reached.

ASSUMPTION (continued)

Oversight has prepared the following table which summarizes the EPARC estimates of revenue reduction for this provision.

	Business Income Subtraction	Net Tax Due	
Baseline	0	$5,109,439,000	NA
Year 1	10%	$5,033,833,000	$75,606,000
Year 2	20%	$4,959,929,000	$149,510,000
Year 3	30%	$4,887,377,000	$222,062,000
Year 4	40%	$4,816,166,000	$293,273,000
Year 5	50%	$4,746,685,000	$362,754,000

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 until the requirement is met again.

Section 143.071, RSMo. - Corporate Income Tax Changes:

This provision would provide a phased in reduction in the corporate income tax rate, 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 fifty million dollars.

Officials from the **Office of Administration - Division of Budget and Planning (BAP)** assume this proposal would reduce the corporate tax rate in a series of incremental 0.6% steps, from 6.25% to 3.25%.

ASSUMPTION (continued)

BAP officials stated in FY 2013, $360.8 million in net corporate taxes were received. Therefore, this proposal would reduce Total State Revenues as in the chart below. If the first reduction occurs for 2015, taxpayers would adjust declarations beginning January 2015, and this proposal could reduce Total State Revenues in FY 2015 by an estimated $10.4 million.

Year	Corporate Income Tax Rate	Estimated Revenue	Estimated Revenue Reduction
2013 (Baseline)	6.25%	$360,800,000	NA
Year 1	5.65%	$326,200,000	$34,600,000
Year 2	5.05%	$291,500,000	$69,300,000
Year 3	4.45%	$256,900,000	$103,900,000
Year 4	3.85%	$222,300,000	$138,500,000
Year 5	3.25%	$187,600,000	$173,200,000

Officials from the **Department of Revenue (DOR)** assume this proposal would, beginning with 2015, reduce the tax rate on corporate income over a period of years. The reductions would be three-fifths of one percent and no more than one reduction would be made per year. The rate would not be reduced below three and one-forth percent, and a reduction would only be made if net general revenue collected in the previous year exceeded the highest of the three previous fiscal years by $150 million.

ASSUMPTION (continued)

DOR officials noted for calendar year 2011, Missouri corporate taxpayers reported $5.8 billion in taxable income and paid $361.4 million in tax. Based on that tax of $361.4 million, DOR officials estimated the following reduction in corporate income tax:

First year -	$34.7 million
Second year -	$69.4 million
Third year -	$104.1 million
Fourth year-	$138.8 million
Fifth year -	$173.5 million

Administrative impact

DOR officials assume Corporate Tax would need to make form changes, but as this is not effective until January 1, 2015, Corporate Tax wold roll it into the other year-end tax 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.

Summary of DOR cost estimate

The DOR response included five additional employees; with benefits, equipment, and expenses, the DOR estimate of cost to implement this proposal totaled $208,138 for FY 2015, $206,774 for FY 2016, and $2085,925 for FY 2017.

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.

ASSUMPTION (continued)

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.

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

This provision would reduce the corporate income tax rate by 0.6% in 2015, continuing to reduce this rate by 0.6% each year until it reaches its minimum of 3.25% in 2019.

Oversight has prepared the following table which summarizes the EPARC estimates of revenue reduction for this provision.

Year	Corporate Income Tax Rate	Estimated Revenue	Estimated Revenue Reduction
Baseline	6.25%	$397,939,000	NA
Year 1	5.65%	$359,737,000	$38,202,000
Year 2	5.05%	$321,535,000	$76,404,000
Year 3	4.45%	$283,333,000	$114,606,000
Year 4	3.85%	$245,130,000	$152,809,000
Year 5	3.25%	$206,928,000	$191,011,000

ASSUMPTION (continued)

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 until the requirement is met again.

Oversight will use the EPARC estimates 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.

Section 143.221, RSMo. - Withholding Tax Filing Requirement:

Changes to this provision would increase the amount of accumulated withholding tax at which an employer would be required to file and pay withholding taxes on a quarterly bases. An employer who did not meet this threshhold would be required to file on an annual basis.

In response to similar language, officials from the **Office of Administration - Division of Budget and Planning (BAP)** assumed the provision would not result in any additional costs or savings to their organization.

BAP officials noted the proposal would increase the threshold for annual withholding filers from $20 to $100. Withholding taxes that would have otherwise been collected on a quarterly basis in April, July, and October would be delayed until January. The proposal would not directly impact Total State Revenues in the aggregate, but could have a cash flow impact across fiscal years.

Assuming the proposal would become effective Aug. 28, 2014, quarterly payments due in October 2014 would instead be remitted in January 2015. This would have no cash effect overall for FY 2015, though timing of payments are different. However, quarterly payments due in April and July of 2015 would not arrive until January 2016. Therefore, revenue collections would be reduced in FY 2015, but the payments in FY 2016 would be increased by similar amounts. Further, similar patterns would follow in subsequent years.

ASSUMPTION (continued)

Department of Revenue (DOR) officials informed BAP that about 6,500 businesses would be impacted by this proposal. BAP deferred to DOR for estimated withholding amounts.

Officials from the **Department of Revenue (DOR)** assumed the proposal would raise the quarterly aggregate amount required to file a withholding return from $20 to $100.

Fiscal impact

DOR officials assumed the proposal would not reduce Total State Revenue, but would delay the collection of withholding taxes. The legislation would impact approximately 3,500 businesses that would currently file and pay withholding in April, July, and October. Those filers could delay the remittance of their withholding taxes until January of the following year.

Assuming the state could earn a five percent rate of interest, this provision could Reduce Total State Revenue by $17,500 annually.

Administrative impact

The DOR response did not include any estimate of administrative cost involved in implementing this proposal and **Oversight** assumes any administrative costs would be minimal and could be absorbed with existing resources.

IT impact

DOR officials provided an estimate of the IT cost to implement the proposal of $1,092 based on 40 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.

ASSUMPTION (continued)

Oversight assumes this provision would allow certain employers to delay filing and paying withholding taxes, which are currently due on a quarterly basis, until the following January 31. The amount of tax due and the overall amount of revenue for a tax year would not change; however, implementing the amendment could delay receipt of withholding taxes as explained below.

* Taxes withheld for the third calendar quarter ending September 30, 2014 are currently filed and paid by October 31, 2014 (FY 2015); the proposal would include those taxes in an annual filing due January 31, 2015 (FY 2015). Those taxes would be received in the same fiscal year as currently required, although filing and payment of those funds would be delayed three months. For fiscal note purposes there would be no impact from that delay.

* Taxes withheld for the fourth calendar quarter ended December 31, 2014 would be paid January 31, 2015 (FY 2015) as currently required.

* Taxes withheld for the first calendar quarter ending March 31, 2015 would currently required to be filed and paid by April 30, 2015 (FY 2015). The proposal would include those taxes in an annual filing due January 31, 2016 (FY 2016). That delay would be permanent, as each year's first quarter withholding taxes would be paid the following state fiscal year.

* Taxes withheld for the calendar quarters ending June 30, 2015 currently required to be filed and paid by July 31, 2015 and September 30, 2015 currently required to be filed and paid by October 31, 2015 (FY 2016) would be paid by January 31, 2016 (FY 2016). Those taxes would also be paid in the same fiscal year as currently required but would be delayed six months and three months, respectively, as compared to current requirements.

* Based on the number of filers provided by the Department of Revenue, the amount of first calendar quarter withholding taxes delayed over the end of a state fiscal year could range from (3,500 filers x the current $20 threshold) = $70,000 to (3,500 filers x the new $100 threshold) = $350,000.

ASSUMPTION (continued)

For fiscal note purposes, **Oversight** will indicate an unknown revenue reduction for FY 2015 due to first calendar quarter withholding taxes which would be remitted in January, 2016 (FY 2016) rather than April 2015 (FY 2015).

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			
Additional revenue - previous year withholding taxes paid Section 143.221, RSMo	$0	Unknown	Unknown
Revenue reduction - delayed filing and payment of withholding taxes Section 143.221, RSMo	(Unknown)	(Unknown)	(Unknown)
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)
FTE change - DOR	0	4 FTE	4 FTE
Cost - DOR IT cost Personal income tax changes Section 143.022	($65,302)	$0	$0
Revenue reduction - personal income tax changes Section 143.022	$0	($75,606,000)	($75,606,000 to $149,510,000)

(Fully implemented revenue reduction in fifth program year would be $362,754,000.

Revenue reduction - corporate income tax changes Section 143.071	$0	($38,202,000)	($38,202,000 to $76,404,000)

(Fully implemented revenue reduction in fifth program year would be $191,011,000.

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND *	**(More than $65,302)**	**($113,912,210)**	**($113,956,453 to $226,062,453)**

* Fully implemented revenue reduction in the fifth program year would be ($553,765,000)

SAS:LR:OD

FISCAL IMPACT - State Government (Continued)	FY 2015 (10 Mo.)	FY 2016	FY 2017
Estimated FTE effect on General Revenue Fund	0	4 FTE	4 FTE

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 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 $150 million. Shareholders of small corporations and partners in partnerships would be allowed a proportional deduction based their share of ownership.

This proposal would also, beginning with 2015, reduce the tax rate on corporate income over a period of years. Each rate reduction would be three-fifths of one percent and no more than one reduction could be made per year. The tax rate could not be reduced below three and one-forth percent, and a reduction could only be made if net general revenue collected in the previous year exceeded the highest of the three previous fiscal years by $150 million.

SAS:LR:OD

FISCAL DESCRIPTION (continued)

This proposal would change the amount of payroll tax withholding for quarterly filing. Currently, an employer is allowed to file an annual withholding tax return instead of four quarterly returns when the aggregate amount withheld is less than $20 in each of the four preceding quarters. The proposal would change the amount to less than $100 in each of the four preceding quarters if the employer is not otherwise required to file a withholding return on a quarterly or monthly basis.

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
Department of Revenue
University of Missouri
    Economic and Policy Analysis Research Center

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