COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 0782-01
Bill No.: HB 547
Subject: Taxation and Revenue - Income; Department of Revenue
Type: Original
Date: February 27, 2017

Bill Summary: This proposal would require Missouri to add a set of inflation adjustments to Missouri individual income tax rates.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2018	FY 2019	FY 2020
General Revenue	$0	($7,966,000)	($24,744,000)
Total Estimated Net Effect on General Revenue	**$0**	**($7,966,000)**	**($24,744,000)**

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2018	FY 2019	FY 2020
Total Estimated Net Effect on Other State Funds	**$0**	**$0**	**$0**

Numbers within parentheses: ( ) indicate costs or losses.
This fiscal note contains 8 pages.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2018	FY 2019	FY 2020
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2018	FY 2019	FY 2020
Total Estimated Net Effect on FTE	**0**	**0**	**0**

☒ Estimated Net Effect (expenditures or reduced revenues) expected to exceed $100,000 in any of the three fiscal years after implementation of the act.

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2018	FY 2019	FY 2020
Local Government	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

Officials from the **Office of Administration - Division of Budget and Planning (B&P)** assume this proposal would adjust the individual income tax brackets for inflation, as defined in the proposal, starting on January 1, 2018. The first adjustment, for tax year 2018, would reflect the rate of inflation in 1934. Each annual adjustment thereafter would reflect the rate of inflation for the tax year 84 years prior. If there was no inflation during the historical tax year, the Department of Revenue would resume adjustments for historical inflation in the following year. The required adjustments would continue until total adjustments from this proposal equal a total of 17.7%.

This proposal would automatically sunset two years after its effective date unless re-authorized by the General Assembly. For the purpose of this fiscal note, B&P officials estimated the full impact of the proposal assuming it was re-authorized at each required renewal.

Based on data provided by the United States Census Bureau, B&P estimates that inflation adjustments would occur for the historical tax years of 1934 through 1942 which would correspond to tax years 2018 through 2026. B&P notes that there was no inflation during 1938 and 1939. B&P also notes that while inflation in 1942 was equal to 10.9%, B&P only adjusted the individual income tax brackets by 1.1% because the cumulative adjustment cap of 17.7% was met.

Table 1 shows the inflation adjustment and revenue reduction (in millions of dollars) by year.

Year	Reference year	Inflation Adjustment	Revenue Reduction
2018	1934	3.5%	$18.7
2019	1935	2.6%	$31.7
2020	1936	1.0%	$34.0
2021	1937	3.7%	$60.1
2022	1938	0.0%	$52.6
2023	1939	0.0%	$53.0
2024	1940	0.7%	$61.9
2025	1941	5.1%	$87.8
2026*	1942	1.1%	$93.4

*The HB 547 inflation adjustment is 1.1%, since the cumulative adjustment limit of 17.7% is reached. Inflation in 1942 was 10.9%.

ASSUMPTION (continued)

Table 2 shows the inflation adjustment and revenue reduction (in millions of dollars) by state fiscal year.

Fiscal Year	Revenue Reduction
2018	$6.7
2019	$23.4
2020	$32.5
2021	$43.3
2022	$57.4
2023	$52.8
2024	$56.2
2025	$53.9
2026	$89.8
2027	$93.4

Using tax year 2015 data, the most current year available, B&P estimates that this proposal would reduce Total State Revenue and General Revenue in FY 2018 by $6.7 million and once fully implemented in FY 2027 it would reduce Total State Revenue and General Revenue by $93.4 million annually.

Officials from the **Department of Revenue** (**DOR**) assume beginning January 1, 2018, the proposal would require the Department to make additional adjustments to the taxable income tables by the percent increase in inflation that occurred in 1934. For each year thereafter, the Department would adjust the rate equal to the inflation rate for the following year. The Department would make adjustments until the accumulated adjustment totaled seventeen and seven-tenths (17 7/10) percent.

The Department determined the historical yearly average rate of inflation from 1931 to 2015 and combined it with an average rate of future inflation of 2 percent to estimate the change to the tax brackets that would be required by this legislation. Because the inflation adjustment in this section is limited to seventeen and seven-tenths percent, the Department based its calculation on applying the rate of inflation until that total adjustment was met. Using tax year 2014 data, the Department estimates a possible reduction in Total State Revenue by as much as $93.7 million when fully implemented.

ASSUMPTION (continued)

Administrative Impact

DOR officials assume the Personal Tax Division would require form and programming changes, and the Withholding Tax Division would require revisions to the withholding tables and the formula for the new tax rates.

Oversight notes the DOR did not include an administrative cost estimate for this proposal in their response and assumes the proposal could be implemented with existing resources. If unanticipated additional costs are incurred or if multiple proposals are implemented which result in additional costs to DOR, resources could be requested through the budget process.

Officials from the **University of Missouri - Economic and Police Analysis Research Center (EPARC)** assume that if enacted, this proposal would increase the size of the taxable income classes as they apply to the Missouri personal income tax table. This proposal attempts to recapture the inflation increase that occurred between 1934 and 2015 by increasing the tax brackets, year-by-year, between 2018 and 2099 by the same percentage increase evident in the Consumer Price Index (CPI). The 2018 tax brackets would increase by the increase in the CPI in 1934, the 2019 tax brackets would increase by the increase in the CPI in 1935, the 2020 tax brackets would increase by the increase in the CPI in 1936, and so on until the 2099 tax brackets would be increased by the increase in the CPI in 2015. The proposal stipulates that if there was no positive inflation in any given "historical tax year," then no adjustment would be made.

EPARC officials noted that existing legislation would be increasing future tax brackets as well. Starting in 2017, existing legislation would increase the tax brackets by the increase in the CPI from the previous year. This proposal would add its percentage increase to the increase required by current requirements.

EPARC officials stated they we were unable to predict future inflation rates and would use a long-term average inflation rate of 2% for all baseline estimates in this response.

ASSUMPTION (continued)

EPARC officials prepared a set of simulations for this proposal as described below.

A 2018 baseline in which the brackets have been increased 2% from 2017 levels indicated Net Tax Due of $5,799.916 million. A simulation in which the brackets have been increased by an additional 1.52%, the percentage increase in the CPI for 1934, for a total increase of 3.52% from 2017 levels, indicated Net Tax Due of $5,791.950 million for a reduction in Net Tax Due of $7.966 million.

A 2019 baseline which included the 2% increase in Missouri tax brackets from 2018 levels indicated Net Tax Due of $5,787.678 million. A simulation in which the brackets have been increased by 4.99%; the sum of 2.99% from the inflation increase from 1935 and the long-term average inflation rate of 2% indicated Net Tax Due of $5,762.934 million, a reduction of $24.744 million from the baseline.

A 2020 baseline which included the 2% increase in Missouri tax brackets from 2019 levels indicated Net Tax Due of $5,777.084 million. A simulation in which the brackets have been increased by an additional 1.45%, the CPI increase for 1936, for a total increase of 3.45% from 2019 levels indicated Net Tax Due of $5,743.093 million, a reduction of $33.991 million from the baseline.

EPARC officials concluded: If this proposal was enacted we would expect Net General Revenue to be reduced by $7.966 million in 2018, by $24.744 million in 2019, and by $33.991 million in 2020.

Oversight notes this proposal would be effective beginning January 1, 2018, which would have a fiscal impact to the state beginning in January 2019 when individual income tax returns would be filed. Oversight is aware that some taxpayers would adjust withholding or estimated tax payments in anticipation of a tax reduction, but for convenience and clarity will include the full impact for a tax year in the year tax returns would be filed.

Oversight also notes this proposal has a provision which would make the program sunset two years after its effective date; in this case the program would sunset December 31, 2019 and would have no additional impact after that date unless the program is reauthorized. Oversight will only include a fiscal impact for this proposal for FY 2019 (2018 tax returns) and FY 2020 (2019 tax returns).

ASSUMPTION (continued)

Officials from the **Joint Committee on Administrative Rules** assume this proposal would have no fiscal impact on their organization.

Officials from the **Office of the Secretary of State (SOS)** stated 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 SOS 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, the SOS also recognizes 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 the office can sustain with its core budget. Therefore, the SOS reserves 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.

FISCAL IMPACT - State Government	FY 2018 (10 Mo.)	FY 2019	FY 2020
GENERAL REVENUE FUND			
Revenue reduction			
Individual income tax bracket changes	$0	($7,966,000)	($24,744,000)
ESTIMATED NET EFFECT ON GENERAL REVENUE FUND	**$0**	**($7,966,000)**	**($24,744,000)**

FISCAL IMPACT - Local Government	FY 2018 (10 Mo.)	FY 2019	FY 2020
	$0	**$0**	**$0**

FISCAL IMPACT - Small Business

No direct fiscal impact to small businesses would be expected as a result of this proposal.

FISCAL DESCRIPTION

Beginning January 1, 2018, this proposal would require a set of scheduled adjustments to be made to the individual income tax rate brackets.

The provisions would sunset two years from the effective date.

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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February 27, 2017	February 27, 2017

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