COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 6148-10
Bill No.: SCS for HCS for HB 2540 with SSA 1 for SA 1
Subject: Taxation and Revenue - General
Type: Original
Date: May 15, 2018

Bill Summary: This proposal changes the laws regarding taxation.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND				
FUND AFFECTED	FY 2019	FY 2020	FY 2021	Fully Implemented (FY 2023)
General Revenue	$1,700,000	$2,400,000	($3,300,000)	($5,800,000)
Total Estimated Net Effect on General Revenue	**$1,700,000**	**$2,400,000**	**($3,300,000)**	**($5,800,000)**

ESTIMATED NET EFFECT ON OTHER STATE FUNDS				
FUND AFFECTED	FY 2019	FY 2020	FY 2021	Fully Implemented (FY 2023)
Total Estimated Net Effect on Other State Funds	**$0**	**$0**	**$0**	**$0**

Numbers within parentheses: ( ) indicate costs or losses. This fiscal note contains 11 pages.

ESTIMATED NET EFFECT ON FEDERAL FUNDS				
FUND AFFECTED	FY 2019	FY 2020	FY 2021	Fully Implemented (FY 2023)
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)				
FUND AFFECTED	FY 2019	FY 2020	FY 2021	Fully Implemented (FY 2023)
Total Estimated Net Effect on FTE	**0**	**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 2019	FY 2020	FY 2021	Fully Implemented (FY 2023)
Local Government	**$0**	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

Oversight was unable to receive some of the agency responses in a timely manner due to the short fiscal note request time. Oversight has presented this fiscal note on the best current information that we have or on prior year information regarding a similar bill. Upon the receipt of agency responses, Oversight will review to determine if an updated fiscal note should be prepared and seek the necessary approval of the chairperson of the Joint Committee on Legislative Research to publish a new fiscal note.

§143.011 Individual Income Tax
Officials at the **Office of Administration Division of Budget and Planning** (**B&P**) assume that beginning with tax year 2019, this section would reduce the top rate by 0.4%. Beginning with tax year 2020, the top tax rate may be reduced by 0.1%, until five reductions have occurred since tax year 2017. B&P notes that the first 0.1% reduction occurred for tax year 2018, leaving four potential reductions under this proposal. B&P further notes, that if the trigger for SB 509 (2014) were met for tax year 2019, there would be three additional reductions allowed under this proposal. The tax rate shall only be reduced if net general revenue collected in the previous fiscal year is at least $150 million greater than the largest amount of net general revenue collected in the previous three fiscal years. For the purposes of this fiscal note, B&P assumes that each tax rate reduction occurs in consecutive years. B&P acknowledges that it is likely that the net GR requirement is not met every year and thus the rate reductions will not occur; therefore, the earliest this provision could be fully implemented is in FY 2023.

The following table shows the top tax rate under SB 509 (2014) and this proposal

Tax Year	SB 509	Proposal
2018	5.9%	-
2019	5.8%	5.4%
2020	5.7%	5.3%
2021	5.6%	5.2%
2022	5.5%	5.1%

Officials at the **Department of Revenue** (**DOR**) assume that beginning in the 2019 calendar year, this act provides that the top rate of tax shall be eliminated, with a top remaining tax rate reduced to 5.4% for all taxable income over $8,000 (Any rate reductions from SB 509 would continue to be enacted.)

ASSUMPTION (continued)

Every resident having a taxable income shall determine his or her tax from a tax table prescribed by the director of revenue and based upon the rates provided in §143.011. The director shall publish such tax table on or before the October first that immediately precedes the calendar year for which the tax table shall apply.

§143.022 Business Tax
Officials at the **B&P** assume §143.022 would limit the pass-through business exemption to the 20% allowed under current law. B&P notes that as of tax year 2018, the first phase-in of the business pass-through exemption was triggered due to net general revenue growth. B&P further notes that while the pass-through exemption could have begun as early as tax year 2017, net general revenue growth was not sufficient to meet the trigger required for the first phase-in. For the purpose of this fiscal note, B&P assumes that each pass-through business exemption trigger is met in consecutive years.

Officials at the **DOR** assume this proposed section eliminates the final increase in the deduction a pass through entity may deduct from their income, keeping it at 20% in FY 2021. Currently, a pass-through entity can deduct 5% from its 2018 Missouri taxable income. The amount of the deduction was set to increase 5% each year if certain net general revenue limits are met up to a maximum 25% deduction.

§143.151 and §143.161 Personal and Dependent Exemptions
Officials at the **B&P** assume these sections state that individuals may only claim the personal exemption, low-income deduction, and dependent deduction as long as the exemption as defined by federal law is not equal to zero. B&P notes that part of the federal tax reform that began January 1, 2018, placed the personal and dependent exemptions equal to zero until tax year 2025. B&P further notes that the Missouri deductions were eliminated once the federal tax reform was enacted on January 1, 2018. Therefore, B&P estimates that these provisions will not impact Total State Revenue or General Revenue.

Officials at the **DOR** assume this proposed section provides that Missouri personal and dependency exemptions shall not be allowed if the federal exemption amount is zero. Due to the passage of federal tax reform the Department assumes there is no impact.

ASSUMPTION (continued)

§143.171 Individual Federal Income Tax Deduction
Officials at the **B&P** assume this section would phase out the amount of federal taxes an individual may claim based on their federal taxable income. The following table shows the phase-out of the federal income tax deduction.

Federal Taxable Income		FIT Deduction Allowed
Min	Max	
$0	$25,000	35%
$25,001	$50,000	25%
$50,001	$100,000	15%
$100,001	$125,000	5%

Officials at the **DOR** assume this proposed section allows, for all tax years beginning on or after January 1, 1994, an individual taxpayer shall be allowed a deduction for the taxpayer's federal income tax liability under Chapter 1 of the Internal Revenue Code for the same tax year for which the Missouri return is being filed, after reduction for all credits thereon, except the credit for payments of federal estimated tax, the credit for the overpayment of any federal tax, and the credits allowed by the Internal Revenue Code by Section 31 (tax withheld on wages), Section 27 (tax of foreign country and United States possessions), and Section 34 (tax on certain uses of gasoline, special fuels, and lubricating oils). For tax years beginning on or after September 1, 1993, but ending before January 1, 2019, the amount of the deduction shall not exceed five thousand dollars on a single taxpayer's return or ten thousand dollars on a combined return. For tax years beginning on or after January 1, 2019, the amount of the deduction shall be the sum of the following amounts:

If the federal taxable income is:	The deduction is:
Not over $25,000.00	35% of the federal tax liability
Over $25,000 but not over $50,000	25% of the federal tax liability
Over $50,000 but not over $100,000	10% of the federal tax liability
Over $100,000 but not over $125,000	5% of the federal tax liability
Over $125,000	No deduction for the federal tax liability

ASSUMPTION (continued)

B&P Estimated Tax Impact Summary
Using 2015 tax year data, the most recent complete year available, and combining the individual income tax changes in §143.011, §143.022, and §143.171, B&P estimates that this provision will increase Total State Revenue and General Revenue by $1.7 million in FY 2019 and decrease Total State Revenue and General Revenue by ($5.8 million) once fully implemented (FY 2023).

The following table shows the estimated impact by fiscal year.

Fiscal Year	GR Impact
FY 19	$1.7
FY 20	$2.4
FY 21	($3.3)
FY 22	($7.1)
FY 23	($5.8)

DOR Estimated Tax Impact Summary
DOR estimates the following:

Total State Revenue					
	FY19	**FY20**	**FY21**	**FY22**	**FY23**
§143.011-Individual Income Tax Rate changes **§143.171**- Individual Federal Income Tax Deduction based on Federal Tax Income	$1.7	$2.4	($3.3)	($7.1)	($5.8)
Total State Revenue	$1.7	$2.4	($3.3)	($7.1)	($5.8)

EPARC Tax Calculations
In response to the previous version, officials at the **University of Missouri's Economic and Policy Analysis Research Center** (**EPARC**) assumed this bill would reduce the top rate by 0.1% every time the 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 150 million dollars. In addition to the rate reduction, beginning with the 2019

ASSUMPTION (continued)

calendar year, it would also reduce the top rate of tax by 0.5%. An income bracket subject to the top rate would be eliminated once the top rate of tax is reduced to 5.5%.

As well, this bill would further limit the federal income tax deduction. Specifically, filers earning over $125,000 in Missouri adjusted gross income would no longer be able to deduct their federal income tax amount, filers earning between $100,000 and $125,000 would be able to deduct 5% of their federal income tax amount, filers earning between $50,000 and $100,000 would be able to deduct 15% of their federal income tax amount, filers earning between $25,000 and $50,000 would be able to deduct 25% of their federal income tax amount, and filers earning $25,000 or less will continue to be able to deduct 35% of the federal income tax amount. These limitations remain in conjunction with the current caps of $5,000 and $10,000 for single and joint filers respectively.

This bill would also authorize an earned income tax credit. The credit would equal to 10% of filers' federal earned income credit in 2019 and 20% of filers' federal earned income credit in 2020 and beyond.

In this response we will assume that the revenue trigger above will be met every year providing a maximum impact estimate for 2019, 2020 and 2021. The Baseline below shows the personal income tax brackets as they will appear in 2018 under current law. Immediately following the baseline we show the 2019, 2020 and 2021 brackets and rates proposed by this bill.

Baseline

If the Missouri taxable income is:	The tax is:
Not over $1,028 …	1 ½ % of the Missouri taxable income
Over $1,028 but not over $2,056 …	$15 plus 2 % of excess over $1,028
Over $2,056 but not over $3,084 …	$36 plus 2 ½ % of excess over $2,056
Over $3,084 but not over $4,112 …	$62 plus 3 % of excess over $3,084
Over $4,112 but not over $5,140 …	$93 plus 3 ½ % of excess over $4,112
Over $5,140 but not over $6,168 …	$129 plus 4 % of excess over $5,140
Over $6,168 but not over $7,196 …	$170 plus 4 ½ % of excess over $6,168
Over $7,196 but not over $8,224 …	$216 plus 5 % of excess over $7,196
Over $8,224 but not over $9,253 …	$267 plus 5 ½ % of excess over $8,224
Over $9,253 …	$324 plus 5.9 % of excess over $9,253

ASSUMPTION (continued)

Simulation 2019

If the Missouri taxable income is:	The tax is:
Not over $1,028 …	1 ½ % of the Missouri taxable income
Over $1,028 but not over $2,056 …	$15 plus 2 % of excess over $1,028
Over $2,056 but not over $3,084 …	$36 plus 2 ½ % of excess over $2,056
Over $3,084 but not over $4,112 …	$62 plus 3 % of excess over $3,084
Over $4,112 but not over $5,140 …	$93 plus 3 ½ % of excess over $4,112
Over $5,140 but not over $6,168 …	$129 plus 4 % of excess over $5,140
Over $6,168 but not over $7,196 …	$170 plus 4 ½ % of excess over $6,168
Over $7,196	$216 plus 5.3 % of excess over $7,196

The baseline for our analysis shows Net Tax Due is $5,454.004 million. The simulation results of the parameter changes in this bill for 2019 show Net Tax Due equals $5,247.386 million. This is a decrease in Net Tax Due of $206.618 million from the baseline. Therefore, this corresponds to a decrease in Net General Revenue in 2019 of $206.618 million due to this change in the Missouri tax brackets and rates and the federal tax deduction.

2020

If the Missouri taxable income is:	The tax is:
Not over $1,028 …	1 ½ % of the Missouri taxable income
Over $1,028 but not over $2,056 …	$15 plus 2 % of excess over $1,028
Over $2,056 but not over $3,084 …	$36 plus 2 ½ % of excess over $2,056
Over $3,084 but not over $4,112 …	$62 plus 3 % of excess over $3,084
Over $4,112 but not over $5,140 …	$93 plus 3 ½ % of excess over $4,112
Over $5,140 but not over $6,168 …	$129 plus 4 % of excess over $5,140
Over $6,168 but not over $7,196 …	$170 plus 4 ½ % of excess over $6,168
Over $7,196	$216 plus 5.2 % of excess over $7,196

The baseline for our analysis shows Net Tax Due is $5,454.004 million. The simulation results of the parameter changes in this bill for 2020 shows Net Tax Due equals $5,138.168 million. This is a decrease in Net Tax Due of $315.836 million from the baseline. Therefore, this corresponds to a decrease in Net General Revenue in 2020 of $315.836 million due to this change in the Missouri tax brackets and rates and the federal tax deduction.

ASSUMPTION (continued)

2021

If the Missouri taxable income is:	The tax is:
Not over $1,028 …	1 ½ % of the Missouri taxable income
Over $1,028 but not over $2,056 …	$15 plus 2 % of excess over $1,028
Over $2,056 but not over $3,084 …	$36 plus 2 ½ % of excess over $2,056
Over $3,084 but not over $4,112 …	$62 plus 3 % of excess over $3,084
Over $4,112 but not over $5,140 …	$93 plus 3 ½ % of excess over $4,112
Over $5,140 but not over $6,168 …	$129 plus 4 % of excess over $5,140
Over $6,168 but not over $7,196 …	$170 plus 4 ½ % of excess over $6,168
Over $7,196	$216 plus 5.1 % of excess over $7,196

The baseline for our analysis shows Net Tax Due is $5,454.004 million. The simulation results of the parameter changes in this bill for 2021 shows Net Tax Due equals $5,042.486 million. This is a decrease in Net Tax Due of $411.518 million from the baseline. Therefore, this corresponds to a decrease in Net General Revenue in 2021 of $411.518 million due to this change in the Missouri tax brackets and rates and he federal tax deduction.

Conclusion: As stated above, we restricted our analysis to those changes pertaining to the individual income tax. If this bill were enacted we would expect Net General Revenue to decrease by $206.618 million in 2019, decrease by $315.836 million in 2020 and then decrease by $411.518 million in 2021 due to the portions of this bill that changes the Missouri individual income tax code.

As noted in several other fiscal notes this year regarding taxation, EPARC does not account for SB 509 scheduled tax rate changes in its calculations. Also, EPARC ran the scenarios including the triggered events (additional reduction of the individual income tax rates as well as the Missouri Working Family Tax Credit), which are no longer in the bill. Therefore, **Oversight** will use the estimates provided by B&P and DOR in the fiscal note.

<u>FISCAL IMPACT - State Government</u>	FY 2019 (6 Mo.)	FY 2020	FY 2021	Fully Implemented (FY 2023)
GENERAL REVENUE				
<u>Revenue</u> - changes to individual income tax §143.011 & 143.171	$1,700,000	$2,400,000	($3,300,000)	($5,800,000)
ESTIMATED NET EFFECT ON GENERAL REVENUE	**$1,700,000**	**$2,400,000**	**($3,300,000)**	**($5,800,000)**

<u>FISCAL IMPACT - Local Government</u>	FY 2019 (6 Mo.)	FY 2020	FY 2021	Fully Implemented (FY 2023)
	$0	**$0**	**$0**	**$0**

<u>FISCAL IMPACT - Small Business</u>

Some small businesses that pay income taxes would be impacted by this proposal.

<u>FISCAL DESCRIPTION</u>

This legislation makes changes to taxation.

This legislation has an effective date of January 1, 2019.

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

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

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Acting Director
May 15, 2018

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