COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 0484-09
Bill No.: SCS for SB 27
Subject: Taxation and Revenue - Income
Type: Original
Date: April 9, 2003

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2004	FY 2005	FY 2006
General Revenue Fund	$6,600,000 to Unknown	$93,000,000 to Unknown	$93,000,000 to Unknown
Total Estimated Net Effect on General Revenue Fund	**$6,600,000 to UNKNOWN**	**$93,000,000 to UNKNOWN**	**$93,000,000 to UNKNOWN**

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2004	FY 2005	FY 2006
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 2004	FY 2005	FY 2006
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2004	FY 2005	FY 2006
Local Government	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

Officials of the **Missouri Gaming Commission, Office of the Attorney General, Missouri House of Representatives, Office of the Governor** and the **Missouri State Senate** assume this legislation makes several changes to the sections relating to taxation. These agencies assume this legislation would not fiscally impact their respective agencies.

Officials from the **Missouri Lottery Commission (LOT)** assume this proposed legislation does not have a fiscal impact on the LOT. The LOT currently withholds Missouri state taxes from winnings over $599 from out-of-state residents.

Officials from the **Office of Administration, Administrative Hearing Commission** anticipate that this legislation will not significantly alter their caseload.

Officials from the **Secretary of State, Administrative Rules (SOS)** assume this bill creates a single-rate tax on individual income with increased personal exemptions. SOS assumes 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 4 new pages of regulations in the Code of State Regulations at a cost of $27 per page, and 6 new pages in the Missouri Register at a cost of $23 per page. Costs due to this proposal are estimated to be $246, however, the actual fiscal impact would be dependent upon

ASSUMPTION (continued)

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 appropriations process. Any decisions to raise fees to defray costs would likely be made in subsequent fiscal years.

Officials from the **Department of Revenue (DOR)** did not respond to our fiscal note request for this substitute. However in a prior response to SB 27, DOR assumed this legislation would decrease the number of lines keyed on the income tax return and the number of errors generated by taxpayers. DOR assumed it would also eliminate any deductions and credits administered by the DOR.

DOR estimated this proposal will result in an unknown savings in FTE, E&E, printing and postage. This savings is expected to be over $100,000.

In a response to HB 600, DOR assumed this similar proposal requires all lottery and other gaming winnings to be included in Missouri nonresident adjusted gross income when the winnings are from a Missouri source. According to the gaming commission, there is $110 million of nonresident casino winnings paid out in Missouri. Therefore, with a 6% tax rate, the increase in revenues totals $6.6 million. This legislation will have no additional impact to DOR.

Officials from the **Office of Administration, Division of Budget and Planning (BAP)** defers Section 143.091 regarding reporting/changes to federal tax law to the Department of Revenue. Sections 1-5 make substantial changes in the state income tax system. BAP defers to the UMC Research Center for an estimate of the fiscal impact of this part of the proposal. Section 143.181 would tax the Missouri gambling winnings for non-Missouri residents. The revenue impacts are best estimated by Department of Revenue and the other agencies directly affected. This bill would have no impact on BAP.

Officials from the **University of Missouri, Research Center (UMRC)** assume the following:

Given the potential for this proposal, UMRC did all the analyses without considering existing income tax credits.

ASSUMPTION (continued)

The proposal would set the tax rate at four percent (4%), limit the standard deduction and eliminate the Federal tax deduction.

Revised standard deduction amounts:

Single, filing status A	10,000
Combined, surviving spouse	20,000
Head of household	15,000
Claimed as a dependent	0 (not provided in proposal)

UMRC assumes the net effect of this proposal would be zero for FY2004. For the next two fiscal years, 2005 and 2006, the net effect would be $67.6 million, depending on changes on the Federal Individual Income Tax Return. DOR could drastically decrease FTE, also creating a savings to Missouri.

UMRC assumes gross tax due is before all credits. This is UMRC's preferred measure of tax liability because it is impossible to simulate and forecast changes in DED and other state tax credits. It is also not usually an issue because most legislation does not alter credit amounts. As a result, the 4 percent rate that produced a $67.6 million gross tax due increase compared to the current law, would produce an additional estimated $300 million surplus if all of the credits were eliminated as well.

UMRC assumes in Sections 2.3 and 2.4 of this proposal, winnings from the lottery and other gambling activities are subject to inclusion in income. This is already true at the federal level. Moreover, lottery winnings over $600 are already subjected to a 4% state withholding upon payment by the Missouri Lottery. For gambling winnings, Federal statute permits filers to deduct losses up to the amount of winnings. In expected value terms, gambling activities lose. The statute is one-sided in that once a taxpayer wins, the taxpayer may deduct losses only up to the value of the winnings. Certainly this looks as if it would generate positive tax receipts. From the state's taxing perspective, the only claim is net winnings which are bounded from below by zero and could, theoretically, be very large. However, the impact on tax revenues must be viewed from the perspective of the question: What is the expected winnings for a person before they go into the casino or purchase the lottery ticket? Since the answer is zero, UMRC concludes that the bill's changes with respect to lottery and gambling winnings would not be a measurable source of tax receipts for the state.

ASSUMPTION (continued)

UMRC assumes with the adjustments to income for nonresidents, tax receipts increase by $18.8 million. Net taxes due are $337 million in the current tax regime and are predicted to be $355.8 million under the flat tax case.

For residents, UMRC assumes there is a big question relating to how filers listed as dependents should be treated. If filers listed as dependents were to receive a $10,000 deduction, tax receipts could be much lower.

With respect to the bill's proposed modifications to residents and nonresidents measures of income, in almost every case, the calculations require some knowledge of the asset holdings for each filer. Since this is not available in the data housed at UMRC, it is impossible to make even an educated guess as to what the revenue implications are.

Overall, the move to the flat tax combined with the modifications suggested in this version of SB 27, UMRC projects that the tax revenues would increase by $86.4 million. Note that $67.6 million of that comes from the change to the flat tax and $18.8 million comes from modified definitions of nonresident income.

Officials from the **Department of Economic Development (DED)** did not respond to our fiscal note request for this substitute. However in a prior response to SB 27, DED assumed they would need to identify and notify individual holders of tax credits that the credits could no longer be applied against individual income taxes after January 1, 2004. This would involve sending a notification to an undetermined number of individuals. It would impact almost every tax credit program administered by DED. This would require some temporary staffing to help with mailings. DED would also anticipate an increase in the number of complaints and calls from individual taxpayers no longer qualifying for tax credits or losing tax credits they had previously been authorized. DED would also anticipate some potential legal issues with the nullification of tax credits that were previously issued to individual taxpayers, up to and including litigation.

DED assumes total state revenue would likely be impacted but in an unpredictable manner. In FY00, about 27% of DED tax credits were claimed against individual income tax liabilities. In FY 2002 there were about $150 million in redeemed credits for programs administered by DED.

DED assumes the need for postage and resources to notify taxpayers that credits can no longer be claimed. DED assumes there may be some court cases filed. DED assumes there may be at least $40 million in DED administered tax credits that would normally be redeemed by taxpayers that this legislation would no longer allow. The state may lose some unknown positive economic

ASSUMPTION (continued)

benefits due to the inapplicability of tax credits to individual income taxes.

Oversight assumes this substitute does not repeal all tax credits, it only requires appropriation before credits over $500,000 can be claimed by an individual or a corporation. This will create an unknown increase in revenue that could vary based on credit amounts outstanding, number of years eligible for carryover and an unknown number of taxpayers/corporations who would have sufficient tax liability to have used their credits in excess of $500,000. **Oversight** will show the revenue impact as zero to unknown. No decrease in FTE, fringe benefits, and equipment and expenses for DED is expected. **Oversight** assumes DED can handle the small increase in workload created by this substitute without temporary assistance.

This legislation would increase Total State Revenues.

FISCAL IMPACT - State Government	FY 2004	FY 2005	FY 2006
GENERAL REVENUE FUND			
Income - General Revenue			
Nonresident casino winnings	$6,600,000	$6,600,000	$6,600,000
Increase in Revenue from Flat Tax	$0	$67,600,000	$67,600,000
Increase in Revenue from modified definitions of nonresident income	$0	$18,800,000	$18,800,000
Increase in Revenue from decrease in tax credits taken (Corporate)	$0	$0 to Unknown	$0 to Unknown
Total Income	$6,600,000	$93,000,000 to Unknown	$93,000,000 to Unknown
Saving - Dept. of Revenue			
Personal Service	Unknown	Unknown	Unknown
Fringe Benefits	Unknown	Unknown	Unknown
Expense and Equipment	Unknown	Unknown	Unknown
Total Savings - DOR	Unknown	Unknown	Unknown

FISCAL IMPACT - State Government	FY 2004	FY 2005	FY 2006

Costs - Dept. of Economic Development			
Expense and Equipment (postage)	(Unknown)	$0	$0
Total Costs - DED	(Unknown)	$0	$0
ESTIMATED NET EFFECT ON GENERAL REVENUE FUND	**$6,600,000 to UNKNOWN**	**$93,000,000 to UNKNOWN**	**$93,000,000 to UNKNOWN**

FISCAL IMPACT - Local Government	FY 2004	FY 2005	FY 2006
	$0	**$0**	**$0**

FISCAL IMPACT - Small Business

Small businesses could possibly have a reduction in paperwork.

DESCRIPTION

This proposal creates a flat tax on individual income of natural persons at a rate of four percent. The proposal also replaces most additions and subtractions from Missouri adjusted gross income with a larger personal deduction of $10,000 per taxpayer ($20,000 for a combined return, $15,000 for a head of household return and $20,000 for a surviving spouse return). The proposal provides both nonresident and partnership allocation and computation of Missouri individual income tax liability.

This proposal requires all lottery and other gaming winnings to be included in Missouri nonresident adjusted gross income when the winnings are from a Missouri source.

This proposal requires tax credits claimed over $500,000 by individuals or corporations to be appropriated.

DESCRIPTION (continued)

This proposal contains an emergency clause.

KS:LR:OD (12/02)

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

Attorney General
Secretary of State
Department of Revenue
Office of Administration
  Division of Budget and Planning
  Administrative Hearing Commission
University of Missouri
  Research Center
Department of Economic Development
Missouri State Senate
Office of the Governor
Missouri House of Representatives
Missouri Gaming Commission
Missouri Lottery Commission

Mickey Wilson

Mickey Wilson, CPA
Director
April 9, 2003