COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 1123-01
Bill No.: SB 320
Subject: Taxation and Revenue - Income
Type: Original
Date: February 21, 2003

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2004	FY 2005	FY 2006
General Revenue	($17,777,829)	($63,924,988)	($99,692,123)
Total Estimated Net Effect on General Revenue Fund	**($17,777,829)**	**($63,924,988)**	**($99,692,123)**

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 6 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 **Department of Revenue (DOR)** state this legislation creates a phased-in earned income tax credit on the Missouri income tax return that is refundable or may be carried forward. The credit is equal to ten percent of the Federal credit in tax year 2004, fifteen percent in 2005, and twenty percent in 2006 and subsequent years.

DOR must notify the claimant if there is potential eligibility for the tax credit.

According to the Federal Statistics of Income Bulletin, there are 378,000 Federal returns filed by Missouri residents claiming an earned income tax credit. DOR assumes this credit will have an extra 20 second impact on all returns processed. The Division of Taxation will need one temporary tax season employee ($8 an hour) for every 75,000 returns filed with this credit and one tax season employee for every 3,000 pieces of correspondence received regarding the credit. DOR will also need one Tax Processing Tech I for every 30,000 additional errors generated by this credit.

DOR assumes the Customer Assistance Bureau will need additional tax assistance field personnel to handle the walk in questions until the credit is maximized. One Field Agent is

ASSUMPTION (continued)

requested for every additional 1,285 walk-ins per year. Also, the Customer Assistance Bureau anticipates the call volume to increase. A telephone collector can handle 2,000 calls per month, therefore, one Telephone Collector is requested for every 24,000 additional calls received regarding this credit.

DOR assumes this legislation will require modifications to the individual income tax systems. The Division of Taxation estimates these modifications, including programming changes, will require 1,384 hours of overtime at a cost of $46,170. Modifications to the income tax returns and schedules would be completed with existing resources. State Data Center charges would increase due to the additional storage and fields to be captured. Funding in the amount of $3,657 would be requested for implementation costs.

In a response to a prior similar proposal, DOR requested 5 Temporary Tax Season Employees to key and process the tax credits in order to maintain current processing times. DOR stated all other FTE needed will be requested through the normal budget process once the DOR has processed the credit and has numbers to determine the amount of errors and correspondence received, and the increase in telephone calls and walk-ins. DOR estimated the modifications to the individual income tax system, including programming changes, would require 1,125 hours of overtime at a cost of $29,422. **Oversight** assumes DOR could handle this proposal with the same resources requested in the prior fiscal note (378,000 returns / 75,000 = 5 temps.) and will show costs for DOR for 5 temporary tax season employees, programming costs of $29,422, and implementation costs of $3,657.

Officials of the **Office of Administration, Budget and Planning (BAP)** assume this proposal creates a state income tax credit equal to10% in CY05, 15% in CY06, 20% thereafter of the Federal earned income tax credit.

BAP assumes that taxpayers will not adjust their withholdings in FY04 to take advantage of this credit. The estimate is based on the amount of earned income tax credit claimed in Missouri in 1999 from the Spring 2001 Statistics of Income. Annual growth of 4% is assumed, based on U.S. Treasury forecasts. The lower limit is based on the assumption that only 85% of taxpayers that use the Federal credit will use the state credit. The upper limit assumes 100% of taxpayers that use the Federal credit will use the state credit. The credit will lower revenues by $60.5 million to $71.2 million in FY05, $94.4 to $111.1 million in FY06, and $130.9 to $154 million in FY07 when it is fully phased in.

BAP assumes this proposal would have no impact on their agency.

ASSUMPTION (continued)

According to officials at the **University of Missouri, Research Center**, there was a total number of 384,191 Federal returns with $631 million in Federal earned income tax credits filed with a Missouri address for 2001. Of this amount on matched Missouri returns, $39 million out of $56 million in earned income tax credits was found to be refundable.

Based on UMRC's response and assuming a 4% growth rate, **Oversight** assumes this proposal would generate Federal earned income tax credits of $709.79 million in FY05 and $738.18 million in FY06. Using the proposed rates for a Missouri earned income tax credit for tax year 2004 filed in FY05, and tax year 2005 filed in FY06; would calculate to $71 million state revenue loss in FY05 and would yield a $111 million revenue loss in FY06. By FY07 when the credit is fully phased in, it will reduce revenue by $154 million.

Based on conversations with other states that currently have an earned income tax credit in place and the provision in this proposal that requires the Department of Revenue to notify potentially eligible filers, **Oversight** assumes that 90% of taxpayers who use the Federal credit will use the state credit the first two fiscal years. Then, for FY07, **Oversight** assumes that 95% of taxpayers who use the Federal credit will use the state credit.

Oversight assumes the DOR would require verification of eligibility. In the absence of such verification, total credits could be significantly greater than estimated.

Oversight estimates a loss to the General Revenue Fund of $18 million for FY 2004 due to the possibility of reduced withholding and estimated income tax payments for calendar year 2004. Oversight assumes 25% of Missouri taxpayers would adjust payments, however it should be noted that this amount could be less depending on the taxpayers' awareness of this credit in determining state income tax and their desire to adjust withholdings or estimated payments.

This proposal would result in a decrease in Total State Revenues.

FISCAL IMPACT - State Government	FY 2004 (10 Mo.)	FY 2005	FY 2006
GENERAL REVENUE FUND			
Loss to General Revenue Fund			
Earned Income Tax Credit	($17,744,750)	($63,881,100)	($99,654,300)
Cost - Department of Revenue			
Personal Service (5 Temps.)	$0	($32,438)	($32,438)
Expense and Equipment	$0	($11,450)	$0
Programming	($33,079)	$0	$0
Total Costs - DOR	($33,079)	($43,888)	($37,823)
ESTIMATED NET EFFECT ON GENERAL REVENUE FUND	**($17,777,829)**	**($63,924,988)**	**($99,692,123)**

FISCAL IMPACT - Local Government	FY 2004 (10 Mo.)	FY 2005	FY 2006
	$0	**$0**	**$0**

FISCAL IMPACT - Small Business

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

DESCRIPTION

This proposal allows a state individual income tax credit equal to a percentage of any earned income tax credit claimed by the taxpayer on the federal income tax return. The percentage of the federal credit allowed will be 10% for tax year 2004, 15% for tax year 2005, and 20% for tax year 2006 and thereafter. Any amount of credit which exceeds the taxpayer's liability in any tax year will be refunded to the taxpayer or carried forward into future tax years.

DESCRIPTION (continued)

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
University of Missouri Research Center
Office of Administration, Budget and Planning

Mickey Wilson

MICKEY WILSON, CPA
DIRECTOR
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