COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 4535-05
Bill No.: HB 1639
Subject: Taxation and Revenue - Income; Corporations; Revenue Dept.
Type: Original
Date: March 20, 2012

Bill Summary: This proposal would reduce the taxability of business income for individuals, would reduce the corporate income tax rate, and would reduce the amount available for historic rehabilitation tax credits.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2013	FY 2014	FY 2015
General Revenue	($110,163,849)	($108,464,231)	($184,766,926)
Total Estimated Net Effect on General Revenue Fund	**($110,163,849)**	**($108,464,231)**	**($184,766,926)**

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2013	FY 2014	FY 2015
Total Estimated Net Effect on Other State Funds	**$0**	**$0**	**$0**

Numbers within parentheses: ( ) indicate costs or losses.
This fiscal note contains 13 pages.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2013	FY 2014	FY 2015
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2013	FY 2014	FY 2015
General Revenue	7	7	7
Total Estimated Net Effect on FTE	**7**	**7**	**7**

☐ 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 2013	FY 2014	FY 2015
Local Government	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

Officials from the **Office of the Secretary of State** (SOS) stated that 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, 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 this proposal would not have a fiscal impact to their organization in excess of existing resources.

Officials from the **Office of Administration, Office of the Commissioner**, deferred to the Division of Budget and Planning for an estimate of the fiscal impact of this proposal.

Officials from the **University of Missouri, Economic and Policy Analysis Research Center** (EPARC) assume this proposal would, if enacted, gradually reduce the corporate tax rate as well as phase-in a “business income” subtraction from individual taxpayers’ Federal Adjusted Gross Income when determining their Missouri Adjusted Gross Income. This proposal would reduce historic rehabilitation tax credit authorizations by the amount of revenue lost due to the aforementioned corporate tax cut and “business income” subtraction.

Business Income Subtraction for Individual Income Tax Filers

EPARC officials defined “business income” for the Missouri form 1040 as incomes reported on Schedules C, E and F for filers who reported Schedule C income or Partnership/S-Corp income on Schedule E. The EPARC analysis determined that such income totaled $13.8 billion for the 2010 tax year (FY 2011).

ASSUMPTION (continued)

This proposal would phase in a "business income" subtraction from individual taxpayers' Federal Adjusted Gross Income when determining their Missouri Adjusted Gross Income. It would allow a 10% subtraction for 2012, a 20% subtraction for 2013, and a 30% subtraction for 2014. Beginning in 2015, the Office of Administration (OA) would determine whether the sum of net Corporate and Individual Income Tax collections for that fiscal year is less than the sum of net Corporate and net Individual Income Tax collections from FY 2010. If OA determines that collections from that fiscal year are indeed less than FY 2010, the "business income" subtraction would remain at 30%. If OA determines that collections from that fiscal year are equal to or greater than FY 2010, the "business income" subtraction for that tax year would be increased to 40% and in the following year the "business income" subtraction would increase to 50%.

Using the Net Tax Due from the latest 2010 individual income tax data as a baseline, EPARC estimated that Net Tax Due would be reduced by $74.3 million in 2012, $146.8 million in 2013, and $217.6 million in 2014. If net tax collections in a subsequent for which OA determines the "business income" subtraction should remain at 30%, the estimated reduction in Net Tax Due would remain at $217.6 million. If OA determined that the "business income" subtraction should be increased to 40%, EPARC estimated a reduction in Net Tax Due of $286.4 million and a reduction of $352.8 million for the following year.

Reduction in the Corporate Tax Rate

This proposal would also reduces the corporate income tax rate from 6.25% in 2011 to 5.625% in 2012, to 5% in 2013, and to 4.375% in 2014. Beginning in 2015, the Office of Administration (OA) would determine whether the sum of net Corporate and Individual Income Tax collections from that fiscal year is less than collections from FY 2010. If OA determined that collections from that fiscal year are indeed less than FY 2010 collections, the corporate income tax rate would remain at 4.375%. If OA determined that collections from that fiscal year are equal to or greater than FY 2010 collections, the corporate income tax rate for that tax year would be reduced to 3.75% and the tax rate would be reduced to 3.125% for the following year.

ASSUMPTION (continued)

Using the most recent corporate income tax data (2009) EPARC estimated an aggregate liability of $356.317 million. Cutting the corporate tax rate to 5.625% in 2012 would reduce the aggregate corporate income tax liability by $35.6 million. Cutting the corporate tax rate to 5% in 2013 would reduce the aggregate corporate tax liability by $71.3 million., and cutting the corporate tax rate to 4.375% in 2014 would reduce the aggregate corporate tax liability by $106.9 million. In an interim year or years for which OA determined the corporate income tax rate should remain at 4.375%, the EPARC estimated revenue reduction would remain at $106.9 million. For the year in which OA determined the corporate income tax rate should be reduced to 3.75%, the EPARC estimated revenue reduction for corporate income tax would be $142.5 million and in the following year for which the corporate tax rate would be reduced to 3.125%, EPARC estimated a revenue reduction of $178.2 million.

Reduction in Historic Preservation Tax Credits

This proposal would require a reduction in Historic Preservation tax credit authorizations to replace revenue lost as a result of the corporate and individual income taxes.

EPARC officials stated that they were not able to estimate the impact this provision may have on any particular year's revenue due to the differential timing of credit authorization, credit issuance, and redemption as it pertains to carry-back and/or carry-forward clauses in existing legislation.

Conclusion

If this proposal was enacted, the combined impact of the "business income" subtraction and the reduction in the corporate income tax rate would be a reduction in Net General Revenue of $110 million in 2012, $218.1 million in 2013, and $324.5 million in 2014. In an interim year for which OA determined that the "business income" subtraction should remain at 30% and the corporate income tax rate should remain at 4.375%, EPARC assumed there would be a reduction in Net General Revenue of $324.5 million. For the year for which OA determines the "business income" subtraction should be increased to 40% and the corporate income tax rate should be reduced to 3.75%, EPARC estimated a reduction in Net General Revenue of $428.9 million. For the following year EPARC estimated a reduction in Net General Revenue of $531 million.

ASSUMPTION (continued)

EPARC officials noted that revenue changes over a 2-year period must first be observed before a proper estimate of an equivalent reduction in tax credit authorizations could be possible. Accordingly, an equivalent reduction in tax credit authorizations must be reactive and take place in the subsequent tax year.

Officials from the **Department of Revenue** (DOR) assume this proposal would phase in a reduction in the taxability of business income for individuals and would also phase in reduced corporate income tax rates. The reduction in the individual and corporate income tax would reduce total state revenue.

Fiscal impact

For calendar year 2010, Missouri individual income tax filers reported $10.4 billion in "business" income on their federal 1040s. DOR included the totals reported on Schedule C, Schedule D, Schedule E and Schedule F in the calculation. Some portion of the $10.4 billion reported could have been earned outside the state of Missouri and would not have been taxable in Missouri. In addition, the $10.4 billion estimate does not include any Missouri business income included on a federal return filed by an individual that did not have a Missouri address.

Based on $10.4 billion in business income, and an effective individual tax rate of approximately 4 percent (6% minus modifications and deductions), DOR estimated the following reduction in individual income tax:

2012	$41 million
2013	$83 million
2014	$125 million

Any additional reductions would be based on a comparison to FY 2012 revenues.

ASSUMPTION (continued)

For calendar year 2009, Missouri corporate taxpayers reported $5.1 billion in taxable income and paid $319 million in tax. Based on that tax of $319 million, the Department estimated the following reduction in corporate income tax:

2012	$32 million
2013	$64 million
2014	$95 million

Any additional reductions would be based on a comparison to FY 2012 revenues.

The amount authorized each year for Historic Preservation Tax Credits would be reduced by the amount necessary to replace any revenue lost as a result of the business income tax deduction. However, amounts authorized and issued in the last several years are less than the estimated reduction in individual and corporation tax revenues as early as fiscal year 2013.

Administrative Impact

DOR officials assumed that form changes and programming changes would be needed to various tax systems.

The DOR response included two additional temporary tax employees and seven additional full time employees with equipment, expenses, and floor space totaling $297,732 for FY 2013, $300,498 for FY 2014, and $303,658 for FY 2015.

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 for fiscal year 2012 could be reduced by roughly $5,000 per additional employee.

Oversight 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 expenses in accordance with OA budget guidelines. Finally, Oversight assumes a limited number of additional employees could be accommodated in existing office space.

ASSUMPTION (continued)

IT Impact

The DOR response also included a total of $53,424 in IT cost for the Office of Administration, Information Technology Services Division staff assigned to OA-ITSD (DOR) based on 2,016 hours of programming.

Oversight assumes that 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 budget process.

Officials from the **Office of Administration, Division of Budget and Planning** (BAP) assumed this proposal would not result in additional costs or savings to their organization.

BAP officials stated that this proposal would create a new subtraction of taxable individual business income; would reduce the corporate tax rate; and would reduce the cumulative cap on historic tax credits by an amount intended to be revenue neutral.

Individual Income Tax

This proposal would phase in a deduction of business income from individual income tax, increasing from 10% in 2012, 20% in 2013, 30% in 2014; 40% in the first subsequent year that the sum of individual and corporate income taxes exceed taxes in FY 2012; and 50% every year thereafter. Business income would be defined as: income greater than zero arising from transactions and activity in the regular course of the taxpayer's trade or business, and would include income from tangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

BAP officials totaled information available from the federal Internal Revenue Service Statistics of Income. According to definitions provided by the IRS and the definition of business income above, a portion of dividend and capital gains income would likely qualify as business income under this proposal. Therefore, BAP estimated that 7.2% - 12.6% of net individual income taxes are derived from business income.

ASSUMPTION (continued)

In FY 2011, $4,640.3 billion was collected in net individual income taxes. Using the range calculated above, OA assumed that $334.1 million to $584.7 million in individual income taxes was derived from business income. Therefore, each 10% subtraction in business income would reduce General and Total State Revenues by $33.4 million to $58.5 million. In the year in which the 50% reduction becomes effective, this proposal would reduce General and Total State Revenues by $167 million to $292.4 million annually, notwithstanding any inflationary growth. BAP also noted that FY 2010 individual income tax collections remain below the FY 2008 peak.

Corporate Income Tax

The proposal would reduce corporate income tax rates by 10% each year. The current rate is 6.25%. Therefore, this proposal would reduce the rate to 5.625% for 2012; 5% for 2013; 4.375% for 2014; 3.75% in the first subsequent year that the sum of individual and corporate income taxes exceeds those in FY 2012; and 3.125% for each year thereafter.

BAP officials reported that in FY 2011, $306.1 million was collected in net corporate income taxes. Therefore, each 10% reduction in the rate would Reduce General and Total State Revenues by $30.6 million. In the year in which the 3.125% rate becomes effective, this proposal would reduce General and Total State Revenues by $153.1 million annually, notwithstanding any inflationary growth.

Historic Tax Credits

BAP officials noted that this proposal would lower the cap on historic tax credits by an amount required each year to mitigate the revenue losses above. The current cap on the historic program is $140 million for most projects. Based on the calculations above, revenue losses in FY 2015 (the third tax year) could total $192.1 million, which exceeds allowable authorizations. Further, historic tax credits are rarely redeemed in the same year they are authorized.

Officials from the **Department of Economic Development** assume this proposal would reduce the income tax on businesses and corporations and would also reduce the amount of tax credits available under the Historic Preservation Tax Credit program to replace the lost revenue.

The Historic Preservation Tax Credit Program is administered by DED's Division of Business and Community Services and has a current statutory annual cap of $140 million. BCS assumes this proposal would be cost neutral to the state of Missouri.

ASSUMPTION (continued)

In response to a similar proposal, however, BCS officials stated that Historic Preservation tax credits for a project are authorized at the time the project receives a preliminary approval. When the project is completed and costs are verified, tax credits are issued. BCS officials assumed the reduced tax credit authorizations in the proposal would have an unknown positive impact on the General Revenue Fund. BCS officials stated that the reduction in available authorizations for a year would result in reduced issuances in the second following year.

Oversight notes that this legislation proposes reductions in the taxation of business income, and a reduction in authorized tax credits for the Historic Preservation program which is intended to offset the revenue reduction resulting from the proposed changes to business income taxation. Oversight has consistently reported the fiscal impact of changes to tax credit programs in the year in which the changes become effective, and this proposal would reduce the authorized amount of tax credits in the Historic Preservation program for tax years beginning on or after July 1, 2013 (FY 2014). Oversight assumes the revenue reduction from the changes to business income taxation for 2012 would be reflected in returns filed in FY 2013 and the amount would be known by June 30, 2013. Therefore, the authorized amount of tax credits could be reduced beginning July 1, 2014.

Accordingly, for fiscal note purposes only, Oversight will include an estimate of increased revenue from tax credit program reductions equal to the estimated revenue reduction from changes in business income taxation, up to the amount of the existing program cap.

As explained above by Department of Economic Development officials, tax credits in this program are authorized at the time a project is approved but those tax credits are not issued until the project is completed and eligible costs are certified, approximately two years later. There could be an additional delay between the issuance of tax credits and redemptions. This means that any reduction in tax credit program costs, and any actual savings on a budget or cash flow basis would likely not happen until two years after the reduction in authorized tax credits for the program.

ASSUMPTION (continued)

In response to similar provisions in another proposal, officials from the **Department of Natural Resources** (DNR) stated that the State Historic Preservation Office (part of their organization) is responsible for reviewing and approving rehabilitation work for state tax credits, and that the department receives appropriations from the Economic Development Enhancement Fund in part for review of the applications for the State Historic Preservation Tax Credit application.

DNR officials reported that their FY 2013 Department budget request included $96,732 and 2.54 FTE in Personal Service and $14,437 in Expense and Equipment for this program. DNR officials assumed the appropriation authority from the Economic Development Advancement Fund to the Department State Historic Preservation Office would continue.

Beginning with FY 2014 the amount authorized in each fiscal year for historic preservation tax credit would be reduced by the amount necessary to replace any revenue loss as a result of the business income tax deduction and the reduction in the tax imposed on Missouri taxable income imposed on corporations.

Any changes in the tax credit structure could have an impact on the number of rehabilitation projects the State Historic Preservation Office reviews and approves. The proposal would reduce the state tax on business and corporate income, and would reduce the amount available for low income housing tax credits and historic preservation tax credits. Long term historic preservation efforts towards the rehabilitation and development of commercial and residential historic structures in Missouri may be reduced.

DNR officials deferred to DOR and DED for the amount of tax credits reduced to offset the reduction in the business and corporate tax rate structure.

FISCAL IMPACT - State Government	FY 2013 (10 Mo.)	FY 2014	FY 2015
GENERAL REVENUE FUND			
Cost - Department of Revenue			
Salaries (7 additional FTE)	($128,450)	($154,140)	($155,681)
Temporary employees	($13,000)	($15,600)	($15,756)
Employee benefits	($74,261)	($89,114)	($90,005)
Expense and equipment	($48,138)	($5,377)	($5,484)
Total	($263,849)	($264,231)	($266,926)
Additional revenue - reduction in Historic Preservation Tax Credits	$0	$109,900,000	$140,000,000
Revenue Reduction - Reduced business income taxability	($74,300,000)	($146,800,000)	($217,600,000)
Revenue reduction - Reduced corporate income tax rate	($35,600,000)	($71,300,000)	($106,900,000)
ESTIMATED NET EFFECT ON GENERAL REVENUE FUND	**($110,163,849)**	**($108,464,231)**	**($184,766,926)**
Estimated Net FTE Effect on General Revenue Fund	7	7	7

FISCAL IMPACT - Local Government	FY 2013 (10 Mo.)	FY 2014	FY 2015
	$0	**$0**	**$0**

FISCAL IMPACT - Small Business

This proposal would have a fiscal impact on every small business subject to state income tax, or involved in historic preservation activities.

FISCAL DESCRIPTION

This proposal would reduce the taxability of business income for individuals, would reduce the corporate income tax rate, and would reduce the amount available for historic rehabilitation tax credits.

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
Office of Administration
- Office of the Director
- Division of Budget and Planning

Department of Economic Development
Department of Natural Resources
Department of Revenue
Joint Committee on Administrative Rules
University of Missouri
- Economic and Policy Analysis Research Center

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