

COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 4535-10
Bill No.: Perfected HCS for HB 1639
Subject: Taxation and Revenue - Income; Corporations; Revenue Dept.
Type: Original
Date: May 2, 2012

Bill Summary: This proposal would reduce the tax on business income and corporate income, create a tax amnesty program, and allow the Department of Revenue to implement additional collection procedures for delinquent taxes. The proposal would also create a state debt collection program which the Department of Revenue would administer for the benefit of state agencies. The proposal would add a sales tax exemption for certain industrial inputs, and for certain inputs in food processing, and finally, the proposal would create a sales tax holiday for “Made in USA” products.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2013	FY 2014	FY 2015
General Revenue	(Up to \$111,062,721) to Unknown	(Up to \$218,667,148) to Unknown	(Up to \$325,114,201) to Unknown
Total Estimated Net Effect on General Revenue Fund	(Up to \$111,062,721) to Unknown	(Up to \$218,667,148) to Unknown	(Up to \$325,114,201) to Unknown

Numbers within parentheses: () indicate costs or losses.
This fiscal note contains 29 pages.

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2013	FY 2014	FY 2015
Conservation Commission	Unknown to (More than \$100,000)	Unknown to (More than \$100,000)	Unknown to (More than \$100,000)
Parks, and Soil and Water	Unknown to (More than \$100,000)	Unknown to (More than \$100,000)	Unknown to (More than \$100,000)
School District Trust	Unknown to (More than \$100,000)	Unknown to (More than \$100,000)	Unknown to (More than \$100,000)
Other	Unknown to (More than \$100,000)	Unknown to (More than \$100,000)	Unknown to (More than \$100,000)
Total Estimated Net Effect on <u>Other</u> State Funds	Unknown to (More than \$100,000)	Unknown to (More than \$100,000)	Unknown to (More than \$100,000)

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2013	FY 2014	FY 2015
Total Estimated Net Effect on <u>All</u> Federal Funds	\$0	\$0	\$0

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2013	FY 2014	FY 2015
General Revenue	13	13	13
Total Estimated Net Effect on FTE	13	13	13

☐ 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	Unknown to (More than \$100,000)	Unknown to (More than \$100,000)	Unknown to (More than \$100,000)

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.

ASSUMPTION (continued)

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, Division of Budget and Planning**, (BAP) assume this proposal would not result in additional costs or savings to their organization.

DOR Collections & Enforcement

BAP officials assume the proposal would increase General and Total State Revenue by improving tax collection procedures on delinquent taxes and/or debt owed to the state. It would allow the Department of Revenue (DOR) to retain 1% of the amount of any local sales or use tax collected to cover their costs. The proposal would also give DOR authority to collect debt on behalf of other state agencies, and allow DOR to send out certain mailings by first class mail instead of certified mail.

BAP officials deferred to the Department of Revenue for estimates of the cost and increased revenue collections resulting from these operational efficiencies and programs.

Tax Amnesty Program

The proposal would create an amnesty from accrued penalties and interest on unpaid taxes, if taxes are appropriately filed and paid during a period from August 1, 2012, to October 30, 2012. This proposal appears to be similar to the amnesty program in FY 2003.

BAP officials estimate that \$75 million in revenues would be collected, including \$50 million already identified from DOR investigations completed or in process. The \$50 million is part of the revenue base when the consensus revenue estimates are determined for FY 2013 and future years. BAP officials assume \$25 million of these revenues would be "new" revenues from previously unidentified sources. Of these figures, an estimated 84.2% of amounts collected would be deposited to the General Revenue Fund, based on the results of the amnesty program in FY 2003.

ASSUMPTION (continued)

Further, BAP officials assume that the proposed amnesty would persuade taxpayers to settle accounts in a more timely fashion than is typical. Based on data provided by DOR, BAP officials estimate that 27% of liabilities collected are currently settled within nine months of being identified by the DOR, with others taking 36 months or more to settle. BAP officials assume the amnesty would bring all of these payments into the three-month amnesty window, which occurs about nine months after the end of 2011. This would have an additional positive cash flow impact in FY 2013, at the expense of payments that would have otherwise been received in later years.

BAP officials assume this proposal would result in changes in the timing of collections for Total State Revenues and for the General Revenue Fund as shown below.

Total State Revenue	Total	2013	2014	Subsequent Years
Amnesty Collections	\$75.0	\$75.0	\$0.0	\$0.0
Normal Collections	(\$50.0)	(\$13.6)	(\$22.8)	(\$13.6)
Net	\$25.0	\$61.4	(\$22.8)	(\$13.6)

General Revenue Fund (84.2% of Total)	Total	2013	2014	Subsequent Years
Amnesty Collections	\$63.2	\$63.2	\$0.0	\$0.0
Normal Collections	(\$42.1)	(\$11.4)	(\$19.2)	(\$11.5)
Net	\$21.1	\$51.8	(\$19.2)	(\$11.5)

ASSUMPTION (continued)

Individual Income Tax

BAP officials also noted that this proposal would phase in a deduction of business income for individual income tax filers. The phase-in would begin in 2012, or the first year that state collections of net individual income and net corporate taxes exceed collections for those taxes in fiscal year 2010. The deduction would increase from 10% in the first year to 50% in the fifth year that revenues exceed the FY 2010 calculation, and would continue at 50% for subsequent years. 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 reported that the Internal Revenue Service (IRS) Statistics of Income (SOI) indicated a portion of dividend and capital gains income would also likely qualify as business income under this proposal and BAP officials estimated that 7.2-12.6% of net individual income taxes are derived from business income.

In FY 2011, \$4,640.3 million was collected in net individual income taxes. Using the range presented above, between \$334.1 million and \$584.7 million in individual income taxes was derived from business income. Therefore, a 10% reduction in business income would reduce general and total state revenues by \$33.4 million to \$58.5 million beginning as early as FY 2013. In the year in which the 50% reduction becomes effective, General and Total State Revenues would be reduced by \$167 million to \$292.4 million annually, notwithstanding any inflationary growth.

Corporate Income Tax

This proposal would phase in a corporate income tax rate reduction. The phase-in would begin in 2012, or in the first year state collections of net individual income and net corporate taxes exceed the collections for those taxes in fiscal year 2010. The deduction would increase from 10% in the first year to 50% in the fifth year that revenues exceed the FY 2010-calculation, and would continue at 50% for subsequent years.

ASSUMPTION (continued)

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, beginning as early as FY 2013. 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.

BAP also noted that FY2010 net corporate and individual income taxes were well below the FY 2008 peak.

Sales Tax Exemption for Manufacturing and Food Processing

This section provides sales tax exemptions to certain inputs and items used in manufacturing and food processing. DOR officials reported that proposed Section 144.055.2 RSMo would reverse two Supreme Court decisions which held that preparing a restaurant meal is not manufacturing. DOR officials also reported that this provisions is related to previous refund claims over \$2.1 million. This proposed change would reduce General and Total State Revenues including those for education and local governments, by an unknown amounts possibly exceeding \$10 million.

Sales Tax Refunds

The proposal would provide a process for purchasers to seek refunds from the DOR when the purchaser has overpaid sales tax.

Refund appeals are currently allowed for claims that have been denied to vendors beginning January 1, 2007, but only for claims based on the exemption for electronic transmission or delivery of computer software. DOR officials reported that a total of \$96 million from 3,735 refund claims including General and Total State Revenues and local revenues, has been denied since that date.

DOR also reports that a sample of 67 denials that were appealed resulted in \$2.5 million in additional refunds, for an average of \$37,313 per appeal.

Based on additional data from DOR, BAP assumes there would be between 11 and 56 additional appeals. At the average estimated above, this provision could reduce General and Total State Revenues by \$0.4 million to \$2.1 million.

ASSUMPTION (continued)

Also, to the extent this proposal would increase refund claims in future Years, General and Total State Revenues including those for education and local government, could be reduced. Based on additional data supplied by DOR this provision could reduce general and total state revenues by \$1.8 million to \$5.5 million annually. Additional refund claims may be originated by purchasers, and any refund claims that are subsequently approved would reduce General and Total State Revenues by an additional unknown amount.

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 also change the laws regarding the collection of money owed to the state, establish a tax amnesty program, and provide for additional sales tax exemptions.

EPARC officials stated that they are currently unable to provide estimates for the impact on Missouri Net General Revenue of the collection procedures, tax amnesty, and sales tax exemptions in the proposal. However, EPARC provided an estimate for the proposed changes to individual and corporate income tax.

Individual and Corporation Taxes

Beginning in 2012 the Office of Administration (OA) would compare the sum of net corporate and individual income tax collections from that fiscal year to net corporate and individual income tax collections from FY 2010. If OA determines that collections from that fiscal year are less than in FY 2010, the previous year’s taxes code would remain in place.

- * In the first year for which OA determines that collections are more than for FY 2010, individual filers would be allowed a “business income” subtraction of 10% for the following tax year, and the corporate income tax rate would be reduced to 5.625%.
- * In the second year for which OA determines that collections are more than for FY 2010, individual filers would be allowed a “business income” subtraction of 20% for the following tax year, and the corporate income tax rate would be reduced to 5%.

ASSUMPTION (continued)

- * In the third year for which OA determines that collections are more than for FY 2010, individual filers would be allowed a “business income” subtraction of 30% for the following tax year and the corporate income tax rate would be reduced to 4.375%.
- * In the fourth year for which OA determines that collections are more than for FY 2010, individual filers would be allowed a “business income” subtraction of 40% for the following tax year and the corporate income tax rate would be reduced to 3.75%.
- * In the fifth year for which OA determines that collections are more than for FY 2010, individual filers would be allowed a “business income” subtraction of 50% for the following tax year and the corporate income tax rate would be reduced to 3.125%.

Business Income Subtraction for Individual Income Tax Filers

EPARC officials began by enumerating “business income” for the Missouri 1040. Business income was defined as income reported on Schedules C, E, and F.

Schedule C	\$4.882 billion
Schedule E	\$8.444 billion
Schedule F	<u>\$0.473 billion</u>
Total	<u>\$13.799 billion</u>

Based on the net tax due estimate from the Department of Revenue individual income tax data for 2010 as a baseline, EPARC estimated that net tax due would be reduced by \$74.334 million if individual filers are allowed a 10% “business income” subtraction, \$146.811 million if individual filers are allowed a 20% “business income” subtraction, \$217.620 million if individual filers are allowed a 30% “business income” subtraction, \$286.419 million if individual filers are allowed a 40% “business income” subtraction, and \$352.816 million if individual filers are allowed a 50% “business income” subtraction.

ASSUMPTION (continued)

Corporate Tax Rate Reduction

EPARC officials noted that the latest 2009 corporate income tax data indicated an aggregate tax liability of \$356.317 million. Based on that estimate, EPARC calculated a reduction in corporate tax liability of \$35.632 million if the tax rate was reduced to 5.625%, a reduction of \$71.263 million if the tax rate was reduced to 5%, a reduction of \$106.895 million if the tax rate was reduced to 4.375%, a reduction of \$142.527 million if the tax rate was reduced to 3.75%, and a reduction in tax liability of \$178.158 million if the tax rate was reduced to 3.125%.

The EPARC estimates (in \$ millions) could be summarized as shown in this chart.

Year	Corporate Tax Revenue	Corporate Tax Change	Personal Tax Revenue	Personal Tax Change
Baseline	\$356.317	\$0.000	\$4,481.075	\$0.000
1	\$320.685	(\$35.632)	\$4,406.741	(\$74.334)
2	\$285.054	(\$71.263)	\$4,334.264	(\$146.811)
3	\$249.422	(\$106.895)	\$4,263.455	(\$217.620)
4	\$213.790	(\$142.527)	\$4,194.656	(\$286.419)
5	\$178.159	(\$178.158)	\$4,128.259	(\$352.816)

Oversight notes that any change to individual or corporate tax revenues resulting from these provisions would be contingent on a determination by the Office of Administration that combined corporate and individual income tax revenues were greater than for FY 2010. For fiscal note purposes, Oversight will indicate a reduction in revenue “Up to” the amount estimated by EPARC for that year. Oversight also notes that this proposal would change the tax on business income for years beginning on or after January 1, 2012 and assumes the first returns filed under these provisions would be for 2012 and would be filed in January 2013 (FY 2013)

ASSUMPTION (continued)

Officials from the **Department of Revenue** (DOR) provided the following comments.

Section 32.383 RSMo - Tax Amnesty

These provisions would create an amnesty from the assessment or payment of penalties, additions, and interest imposed on unpaid taxes due on or before December 31, 2011, provided those taxes were reported and paid in full between August 1, 2012 and October 31, 2012

- * Amnesty would not extend to any taxpayer who at the time of payment is a party to any criminal investigation or to any civil or criminal litigation.
- * Upon application by the taxpayer, DOR would not seek to collect any penalty, addition to tax, or interest that may be applicable.
- * Amnesty would be granted only to those taxpayers who have applied for amnesty, have filed a tax return for each taxable period for which amnesty is requested, have paid the entire balance due within sixty days of approval by DOR, and agree to comply with state tax laws for the next eight years from the date of the agreement.
- * If the taxpayer fails to comply with state tax laws at any time during the eight years following the date of the agreement, all penalties, additions to tax, and interest that were waived under the amnesty agreement would become due and payable immediately.
- * If a taxpayer elects to participate in the amnesty program, that election would constitute an express and absolute relinquishment of all administrative and judicial rights of appeal. No tax payment received under this section would be eligible for refund or credit.
- * Nothing in the proposal could be interpreted to prevent DOR from adjusting a taxpayer's return as a result of a state or federal audit.
- * All payments received as a result of the amnesty program, other than revenues earmarked by the state constitution, would be deposited in the General Revenue Fund.

ASSUMPTION (continued)

DOR could create rules to implement the provisions of this section. This proposal would become effective on July 1, 2012, and expire on December 31, 2015; and these provisions include an emergency clause. DOR would create a new amnesty form and notices to issue to taxpayers.

Revenue Impact for Amnesty Program

DOR officials estimate this legislation could have a net positive impact on the General Revenue Fund (GR) of \$51.8 million and on Total State Revenue in fiscal year 2013 of up to \$61.4 million. The department estimates that \$75 million in total funds (\$63 million GR) could be received through amnesty, but \$50 million total funds (\$42 million GR) would have been identified as outstanding liabilities by the department. The department assumes that an overwhelming majority of the \$50 million, plus interest and penalties, could be collected without amnesty. Because the Department has processes and personnel in place to collect delinquent taxes, the \$50 million is taken into consideration when the consensus revenue estimates are determined for FY13 and future years.

Oversight has analyzed the DOR estimates of additional tax collections, but we are not able to determine the reasonableness of those estimates since we do not have access to comparable information for similar programs, nor are we able to review any of the supporting documentation for those estimates since the information is confidential.

Oversight notes that this proposal would require DOR to deposit all collections from the amnesty program, except for those which are earmarked by the Missouri Constitution, into the state General Revenue Fund. Accordingly, Oversight will indicate a positive fiscal impact greater than \$100,000 from this proposal in FY 2013 for the General Revenue Fund, and an unknown positive fiscal impact for the Conservation Commission Fund, and the Parks and Soils and Water Fund. Other state funds and local governments would receive additional tax collections from the improved collection procedures but would not have a fiscal impact from the amnesty program.

Oversight will include unknown additional revenue to the General Revenue Fund and an unknown revenue reduction to local governments for the 1% collection fee on local government sales taxes which are not currently subject to this fee.

ASSUMPTION (continued)

Oversight also notes this proposal would authorize DOR to waive penalties, interest, and additions to tax which would be collected under existing delinquent tax provisions. Oversight assumes the additional taxes collected would exceed the penalties, interest and additional taxes which would otherwise have been collected, and for fiscal note purposes only will indicate an unknown loss of revenue in the General Revenue Fund, the Conservation Commission Fund, and the Parks and Soils Tax Funds in FY 2013 for the potential penalties, interest, and tax additions waived.

Administrative Impact for Amnesty Program

The Department and ITSD-DOR would need to make programming changes to all tax systems to identify eligible periods for amnesty and to impose penalty and interest back if taxpayer is not in compliance for eight years.

DOPR would create a new amnesty form and notices to issue to taxpayers that detail the amount owed and the amount eligible to be waived under the amnesty provisions.

DOR officials assumed, based on 2011 estimates, that there are approximately 490,000 known taxpayers eligible for amnesty and estimated that postage, envelopes and printing would cost $(490,000 \text{ taxpayers} \times \$0.515) = \$252,350$. In addition, DOR officials assume that the Taxation Division would incur costs totaling approximately \$350,000 for the following:

*	Overtime to review correspondence-	\$100,000
*	Overtime to review errors on returns-	\$73,000
*	Staff time to key returns and process payments-	\$145,000
*	Staff time for customer contacts-	\$30,000

DOR officials also recommended an advertising budget of at least \$400,000.

In the alternative, the state could contract with a private vendor to administer the amnesty program. Contracting with a vendor would avoid the direct costs to the department, and vendor payments could be based on the percentage of the debts collected. A number of states and other political subdivisions have contracted with private vendors to run their amnesty programs and have seen very good results.

ASSUMPTION (continued)

Oversight assumes the cost to manage the amnesty program would be less than the cost to employ private vendors. Further, DOR employees and managers would be required to identify the delinquent accounts and approve the waivers of penalties, interest, and additional tax.

Oversight assumes that the additional collections would exceed the cost for these programs.

Oversight will indicate unknown costs in excess of \$100,000 in FY 2013 for the Department of Revenue to administer the amnesty program.

DOR Collections Improvement Program

Section 32.385 RSMo Reciprocal Collection

The Director of Revenue and the Commissioner of Administration could jointly enter into a reciprocal collection and offset of indebtedness agreement with the federal government, under which the state would offset from state tax refunds and other payments to vendors and contractors non tax debt owed to the federal government; and the federal government would offset from federal payments to vendors, contractors, and taxpayers debt owed to the state of Missouri.

Section 32.410 - 460 RSMo State Debt Collection

State agencies could refer debts owed to them to DOR for collection, and DOR could provide collection services on debts referred to the department by a state agency. This authority would not supersede the authority granted to the attorney general.

Debt could be referred at any time after it becomes delinquent and uncontested, and the debtor has no further administrative appeal. Methods and procedures for referral would be required to follow internal guidelines prepared by DOR. The collection procedures and remedies would be in addition to any other procedure or remedy available by law. The agency would send notices to debtors by U.S. mail at the debtor's last known address.

ASSUMPTION (continued)

DOR could use all general remedies afforded creditors of this state in collection of the debt, as well as any remedies afforded the referring state agency, and to the state as a creditor. DOR could not prosecute or defend civil actions on behalf of any other state agency, except as necessary to defend any challenges to a debt referred by a state agency. DOR could employ department staff and attorneys, and at the department's discretion could hire prosecuting attorneys and private collection agencies to collect debts referred by a state agency.

DOR could add ten percent of the total debt referred for the cost of collection, and DOR would have the same authority as the referring department in collecting the debt. DOR could compromise state debt referred to the department in accordance with section 32.378 and any agreement with the referring agency.

Oversight assumes the collection charges would be deposited in the General Revenue Fund to compensate for collection costs incurred on behalf of state agencies, and will include unknown additional revenue to the General Revenue Fund for those collection charges.

DOR and the referring state agencies could exchange such information, including the debtor's Social Security number, as is necessary for the successful collection of the state debt referred, and the referring agency would be required to follow all applicable federal and state laws regarding the confidentiality of information and records regarding the debtor. The confidentiality laws applicable to the particular information received and retained by the agency would apply to the employees of the agency and to DOR.

Section 105.716 RSMo Legal Expense Fund Payments

Except for payments less than ten thousand dollars for property damage, no funds could be expended from the state legal expense fund for settlement of any liability claim except upon the production of a no tax due statement from DOR.

Section 140.910 RSMo Administrative Liens

DOR could file a certificate of lien in circuit court for the collection of delinquent taxes, and could order any person to withhold and pay over to the department assets belonging to, due, or to become due the taxpayer.

ASSUMPTION (continued)

Revenue impact - collections program

DOR officials provided an estimate of the additional collections for each of the provisions in this proposal. Amounts are in millions.

<u>Section</u>	<u>Subject</u>	<u>FY</u> <u>2012</u> <u>General</u> <u>Revenue</u> <u>Fund</u>	<u>FY 2012</u> <u>All funds</u>	<u>FY</u> <u>2013</u> <u>General</u> <u>Revenue</u> <u>Fund</u>	<u>FY</u> <u>2013</u> <u>All</u> <u>funds</u>	<u>FY</u> <u>2014</u> <u>General</u> <u>Revenue</u> <u>Fund</u>	<u>FY</u> <u>2014</u> <u>All</u> <u>funds</u>
32.028, 32.410, 32.420, 32.420, 32.440, 32.450, 32.460	Centralized State Debt Collection	\$0.750	\$1.000	\$4.000	\$6.000	\$5.000	\$7.000
32.087	1% Retention	\$0.350	\$0.350	\$0.350	\$0.350	\$0.350	\$0.350
32.385	Reciprocal offset	\$5.700	\$7.000	\$4.100	\$5.100	\$4.000	\$5.000
105.716	Legal Expense Fund	\$0.050	\$0.050	\$0.100	\$0.100	\$0.100	\$0.100
140.910	Garnishment	\$1.500	\$1.500	\$3.000	\$3.000	\$3.000	\$3.000

For fiscal note purposes, **Oversight** will indicate Unknown additional revenues to the General Revenue Fund and those other state funds which receive state revenues processed by the Department of Revenue, and for local governments.

ASSUMPTION (continued)

Administrative impact - Collections Improvement Program

DOR did not provide a separate analysis of the administrative cost to implement this program, and **Oversight** will analyze the DOR cost estimate as it was submitted, following the remaining DOR comments on the proposal.

Section 144.190 RSMo Refund Claim Process

A taxpayer applying for a refund could submit a written request for DOR to hold the refund claim pending the outcome of legal proceedings on the same or similar grounds or transactions, and DOR would then hold the claim unprocessed pending the outcome of such legal proceedings.

DOR officials stated that this provisions would allow purchasers to appeal refund denials submitted by vendors, as far back as January 1, 2007, if the exemption claimed is solely related to electronic transmission of computer software. The Department has denied 3,735 refund claims totaling approximately \$96 million in state and local funds since January 1, 2007. The Department estimates that 3 to 5 percent of refund claims result from electronic transmission of computer software.

The Department studied a sample of 67 appeals requesting \$12.5 million that were filed on denied sales tax refunds, and more than \$2.5 million of the denied refund claims were subsequently overturned by the Administrative Hearing Commission. This equates to an approximate overturn rate of 20 percent.

Based on the sample above, assuming an additional 10 to 30 percent of previously denied claims would be overturned as a result of this proposal, this proposal could result in an additional 11 to 56 refunds. If the average refund amount is equivalent to the average paid on the 67 accounts noted above, additional nonrecurring refunds between \$410,000 and \$2.1 million across state and local funds could be issued as a result of these provisions.

Approximately \$61 million in sales tax refunds are issued each year. Allowing purchasers to pursue claims that sellers chose not to pursue would likely increase refund claims in future years. Based on the average rate of appeals of denied refunds, the department assumes that allowing purchasers to appeal denied claims would result in recurring refunds between \$1.5 and \$5.5 million annually.

ASSUMPTION (continued)

Oversight will indicate a revenue reduction greater than \$100,000 per year for this provision for the General Revenue Fund, for other state funds which receive sales tax revenues, and for local governments.

Section 190.055 RSMo Sales Tax Exemptions

These provisions would reverse two Supreme Court decisions, which held that preparing a restaurant meal is not manufacturing. The Department received 105 refund claims similar to the claims filed in those two cases, and total refunds requested by those claims was \$2,150,670. If these provisions were enacted, the Department would expect refund claims that far exceed the number and dollar amounts previously submitted, as this would affect any establishment that prepares food. DOR officials estimate a cost of at least \$10 million annually with the possibility that the loss could be substantially higher.

Oversight will indicate a reduction in revenues greater than \$100,000 per year for this provision for the General Revenue Fund, other state funds which receive sales tax revenues, and local governments.

Business Income Tax Reductions

Section 143.013 RSMo would create a reduction in the taxability of individuals' business income and Section 143.071 RSMo would reduce the Missouri corporate income tax rate. DOR officials did not provide an estimate of the revenue impact of these provisions.

Administrative Impact

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

DOR officials submitted an estimate of the cost to implement this proposal, including the Tax Amnesty Program discussed separately. That estimate included two additional temporary tax employees, thirteen additional employees, and the related benefits, equipment, and expense. The estimate also included a computer system upgrade with a cost of \$1.5 million, and totaled \$3,909,830 for FY 2013, \$633,129 for FY 2014, and \$639,758 for FY 2015.

ASSUMPTION (continued)

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 \$6,000 for each 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.

For fiscal note purposes, **Oversight** has separately reported estimated costs for the advertising, systems upgrade, professional services, and postage for this proposal in the estimated cost of the Tax Amnesty and Collections Improvement programs, respectively.

IT Impact

The DOR response also included a total of \$254,559 in IT cost for the Office of Administration, Information Technology Services Division staff assigned to OA-ITSD (DOR) based on 9,606 hours of programming for changes to DOR systems.

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 **Department of Economic Development** assume this proposal would have no fiscal impact on their organization.

Officials from the **Department of Natural Resources** (DNR) noted that this proposal would create an additional sales tax exemption. DNR officials assume the additional exemption would reduce revenues for the Parks, and Soil and Water Tax which supports DNR.

ASSUMPTION (continued)

Amendment 1

These provisions would create a "Made in USA" sales tax holiday for all retail sales except motor vehicles for a seven-day period in July 2013 and July 2014.

Officials from the **Office of the Secretary of State** and the **Joint Committee on Administrative Rules** assumed that similar provisions in HB 1983 LR 6064-01 would have no fiscal impact on their organizations.

Officials from the **Office of Administration, Division of Budget and Planning** (BAP) assumed that similar provisions in HB 1983 LR 6064-01 would not result in additional costs or savings to their organization.

BAP officials noted that, according to Federal Trade Commission guidelines, there are several categories of "Made in USA" products, including products that are entirely manufactured to those partially manufactured in the USA. It is unclear from this proposal if only those products that are "all or virtually all made in the USA" would qualify for the sales tax holiday, or if a broader set of products would also qualify.

BAP officials cited a study prepared by the San Francisco Federal Reserve which provided estimates of the proportion of personal consumption comprised by various product types, as well as what portion would qualify for the "Made in USA" exemption. As shown in Table 1 below, BAP officials estimated that 11.4% of annual sales would qualify for the holiday. Further, since the proposed holiday would last for one week, BAP officials assume $(1 \text{ week} / 52 \text{ weeks}) = 1.9\%$ of annual qualifying sales would be exempt, or $(11.4\% \times 1.9\%) = 0.22\%$ of annual sales. In FY 2011, \$1,810 million in general sales tax was collected. This proposal would reduce those revenues by $(\$1,810 \text{ million} \times .0022) = \3.9 million .

If food is included, BAP officials estimated that 18.7% of annual sales would qualify for the holiday. Further, since the proposed holiday would last for one week, BAP officials assume 1.9% of annual qualifying sales would be exempt, or 0.36% of annual sales. Based on FY 2011 collections, the proposed holiday would reduce dedicated sales taxes as shown in Table 2.

Local sales taxes would also be reduced should the municipality choose to participate.

ASSUMPTION (continued)

Table 1 Exempt Sales

Category	Expenditure Percent	Made in USA Percent	Exempt percent
Furniture and Household Equipment	4.7%	59.6%	2.8%
Other Durables	1.8%	69.0%	1.2%
Clothing	3.4%	24.9%	0.8%
Other Nondurables	8.4%	77.7%	6.5%
Total Excluding Food			11.4%
Food	8.0%	90.8%	7.3%
Total Including Food			18.7%
Motor Vehicles	3.4%	74.9%	2.5%

Table 2 Revenue Reduction

General Revenue Fund	\$3.9
Conservation Commission Fund	\$0.3
Parks, and Soil and Water Fund	\$0.2
School District Trust Fund	\$2.4

Officials from the **Department of Revenue** (DOR) assumed that similar provisions in HB 1983 LR 6064-01 would exempt from sales tax any item eligible under the United States Federal Trade Commission rules as eligible for the “Made in USA” designation during a period beginning July 1 and ending July 7. The holiday would be provided in 2013 and 2014. Any political subdivision could choose to allow the sales tax holiday to apply to its local sales taxes.

ASSUMPTION (continued)

DOR officials assumed that Collections and Tax Assistance (CATA) would require one additional FTE Revenue Processing Technician I (Range 10, Step L) for each 7,500 additional file maintenance items processed, and one additional FTE Revenue Processing Technician I (Range 10, Step L) for each 24,000 additional phone calls received, and those employees would require CARES equipment and license.

In addition, DOR officials assumed that Sales Tax would require programming to establish an item tax reported on a separate sales tax holiday line on taxpayers' returns for political subdivisions that do not participate in the holiday. The department would need to notify approximately 1,500 cities, counties and districts how to participate in the holiday, which would add mailing and printing costs as follows.

Letters	.025 x 1500 =	\$ 37.50
Envelopes	.040 x 1500 =	60.00
Postage	.450 x 1500 =	<u>675.00</u>
Total		<u>\$ 772.50</u>

Each year, the department would send approximately 20,000 businesses a holiday notification informing them how to collect and report holiday related sales tax for locals only and how to report the exemption on their return.

Letters	\$0.025 x 20,000 =	\$ 500.00
Envelopes	\$0.040 x 20,000 =	800.00
Postage	\$0.450 x 20,000 =	<u>\$ 9,000.00</u>
Total		<u>\$10,300.00</u>

This Sales Tax Holiday would impact two filing periods (July Monthly Returns and July-September Quarterly returns). Because businesses would be required to differentiate sales tax collected in political subdivisions that do not participate, the proposal could potentially eliminate a substantial volume of the July - One and Two Location Voucher returns and Quarterly (July-September) - One and Two Location Voucher Returns that can be processed without human intervention. This would result in additional hand keying by department staff and would add to the complexity of filing for the impacted businesses.

ASSUMPTION (continued)

DOR officials provided a cost estimate to implement this proposal which included two additional employees and the related benefits, equipment, and expense totaling \$91,154 for FY 2013, \$92,483 for FY 2014, and \$93,618 for FY 2015.

Oversight notes that this proposal would provide two brief sales tax holidays; one in 2013 and one in 2014. Although the holidays could result in consumers delaying purchases for a limited time before the holiday, Oversight will assume the holidays would only impact taxable sales in FY 2013 and FY 2014. Oversight also assumes that DOR would notify local governments and retailers of the sales tax holiday in advance, and in regularly scheduled communications. Accordingly, Oversight assumes that any additional cost to DOR related to this proposal would be minimal and could be absorbed with existing resources. If unanticipated additional costs are incurred, or if multiple proposals are implemented which increase the DOR workload, resources could be requested through the budget process.

IT impact

DOR officials provided an estimate of the IT impact to implement these provisions of \$26,712 based on 1,008 hours of programming to make changes to DOR systems.

Oversight assumes ITSD-DOR is provided with core funding to handle a certain amount of activity each year. Oversight assumes ITSD-DOR could absorb the costs related to this proposal. If multiple bills pass which require additional staffing and duties at substantial costs, ITSD-DOR could request funding through the appropriation process.

Oversight assumes this proposal would reduce sales tax revenues but is not able to determine the extent to which additional retail sales would be exempted by this proposal. Accordingly, Oversight will indicate a revenue reduction greater than \$100,000 for the state General Revenue Fund and for those other state funds which receive sales tax revenues.

Officials from the **City of Columbia** assumed that since similar provisions in HB 1983 LR 6064-01 would appear to be voluntary for cities at this time, it would have no fiscal impact on their organization.

Officials from the **City of Kansas City** assumed that because similar provisions in HB 1983 LR 6064-01 would give the City the choice to opt in to the sales tax holiday, no impact would be expected from the proposal.

ASSUMPTION (continued)

Officials from **St. Louis County** assumed in response to similar provisions in HB 1983 LR 6064-01 that their organization could lose up to \$500,000 per year on a one week sales tax holiday for “Made in the USA” products, based on the assumption that 90% of sales are non-vehicle and 75% of sales are for “Made in the USA” products.

Oversight will not indicate a fiscal impact to local governments since any impact to local government revenues would result from the local government decision to adopt the sales tax holiday.

<u>FISCAL IMPACT - State Government</u>	FY 2013 (10 Mo.)	FY 2014	FY 2015
GENERAL REVENUE FUND			
<u>Cost - Department of Revenue</u>			
Salaries (13 additional FTE)	(\$657,200)	(\$371,196)	(\$374,908)
Temporary employees	(\$13,000)	(\$15,756)	(\$15,914)
Employee benefits	(\$345,030)	(\$194,878)	(\$196,827)
Expense and equipment	(\$81,491)	(\$11,318)	(\$11,552)
Total	<u>(\$1,096,721)</u>	<u>(\$593,148)</u>	<u>(\$599,201)</u>
<u>Additional revenue - Department of Revenue - Tax amnesty program</u>	<u>More than \$100,000</u>	<u>\$0</u>	<u>\$0</u>
<u>Additional revenue - Department of Revenue - Collection procedures</u>	<u>More than \$100,000</u>	<u>More than \$100,000</u>	<u>More than \$100,000</u>
<u>Additional revenue - Department of Revenue - Ten percent collection fees</u>	<u>Unknown</u>	<u>Unknown</u>	<u>Unknown</u>
<u>Additional revenue - Department of Revenue - One percent collection fee</u>	<u>Unknown</u>	<u>Unknown</u>	<u>Unknown</u>
<u>Cost - Department of Revenue - Tax amnesty program</u>	<u>(More than \$100,000)</u>	<u>\$0</u>	<u>\$0</u>

<u>Cost - Department of Revenue -</u> <u>Collection procedures</u>	<u>(More than</u> <u>\$100,000)</u>	<u>(More than</u> <u>\$100,000)</u>	<u>(More than</u> <u>\$100,000)</u>
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<u>Revenue reduction - Department of</u> <u>Revenue - Interest, penalties, and</u> <u>additions to tax waived</u>	<u>(Unknown)</u>	<u>\$0</u>	<u>\$0</u>
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<u>Revenue reduction - Section 144.55 sales</u> <u>tax exemption</u>	<u>(More than</u> <u>\$100,000)</u>	<u>(More than</u> <u>\$100,000)</u>	<u>(More than</u> <u>\$100,000)</u>
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<u>Revenue reduction - Section 144.190</u> <u>sales tax refunds</u>	<u>(More than</u> <u>\$100,000)</u>	<u>(More than</u> <u>\$100,000)</u>	<u>(More than</u> <u>\$100,000)</u>
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<u>Revenue reduction - Made in USA sales</u> <u>tax holiday</u>	<u>(More than</u> <u>\$100,000)</u>	<u>(More than</u> <u>\$100,000)</u>	<u>(More than</u> <u>\$100,000)</u>
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<u>Revenue Reduction - Reduced individual</u> <u>business income taxability</u>	<u>(Up to</u> <u>\$74,334,000)</u>	<u>(Up to</u> <u>\$146,811,000)</u>	<u>(Up to</u> <u>\$217,620,000)</u>
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<u>Revenue reduction - Reduced corporate</u> <u>income tax rate</u>	<u>(Up to</u> <u>\$35,632,000)</u>	<u>(Up to</u> <u>\$71,263,000)</u>	<u>(Up to</u> <u>\$106,895,000)</u>
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ESTIMATED NET EFFECT ON GENERAL REVENUE FUND	<u>(Up to</u> <u>\$111,062,721)</u> <u>to Unknown</u>	<u>(Up to</u> <u>\$218,667,148)</u> <u>to Unknown</u>	<u>(Up to</u> <u>\$325,114,201)</u> <u>to Unknown</u>
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Estimated Net FTE Effect on General Revenue Fund	13	13	13
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**CONSERVATION COMMISSION
FUND**

<u>Additional Revenue - Tax amnesty</u> <u>program</u>	<u>Unknown</u>	<u>\$0</u>	<u>\$0</u>
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<u>Additional Revenue - Collection</u> <u>procedures</u>	<u>Unknown</u>	<u>Unknown</u>	<u>Unknown</u>
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<u>Revenue reduction</u> - Interest, penalties, and additions to tax waived	<u>(Unknown)</u>	<u>\$0</u>	<u>\$0</u>
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<u>Revenue reduction</u> - Section 144.55 sales tax exemption	<u>(More than \$100,000)</u>	<u>(More than \$100,000)</u>	<u>(More than \$100,000)</u>
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<u>Revenue reduction</u> - Section 144.190 sales tax refunds	<u>(More than \$100,000)</u>	<u>(More than \$100,000)</u>	<u>(More than \$100,000)</u>
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<u>Revenue reduction</u> - Made in USA sales tax holiday	<u>(More than \$100,000)</u>	<u>(More than \$100,000)</u>	<u>(More than \$100,000)</u>
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ESTIMATED NET EFFECT ON CONSERVATION COMMISSION FUND	<u>Unknown to (More than \$100,000)</u>	<u>Unknown to (More than \$100,000)</u>	<u>Unknown to (More than \$100,000)</u>
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**PARKS, AND SOIL AND WATER
FUND**

<u>Additional Revenue</u> - Tax amnesty program	<u>Unknown</u>	<u>\$0</u>	<u>\$0</u>
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<u>Additional revenue</u> - Collection procedures	<u>Unknown</u>	<u>Unknown</u>	<u>Unknown</u>
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<u>Revenue reduction</u> - Interest, penalties, and additions to tax waived	<u>(Unknown)</u>	<u>\$0</u>	<u>\$0</u>
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<u>Revenue reduction</u> - Section 144.55 sales tax exemption	<u>(More than \$100,000)</u>	<u>(More than \$100,000)</u>	<u>(More than \$100,000)</u>
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<u>Revenue reduction</u> - Section 144.190 sales tax refunds	<u>(More than \$100,000)</u>	<u>(More than \$100,000)</u>	<u>(More than \$100,000)</u>
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<u>Revenue reduction</u> - Made in USA sales tax holiday	<u>(More than \$100,000)</u>	<u>(More than \$100,000)</u>	<u>(More than \$100,000)</u>
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**ESTIMATED NET EFFECT ON
 PARKS, AND SOIL AND WATER
 FUND**

**Unknown to
(More than
\$100,000)**

**Unknown to
(More than
\$100,000)**

**Unknown to
(More than
\$100,000)**

SCHOOL DISTRICT TRUST FUND

Additional revenue - Department of
 Revenue - Collection procedures

Unknown

Unknown

Unknown

Revenue reduction - Section 144.55 sales
 tax exemption

(More than
\$100,000)

(More than
\$100,000)

(More than
\$100,000)

Revenue reduction - Section 144.190
 sales tax refunds

(More than
\$100,000)

(More than
\$100,000)

(More than
\$100,000)

Revenue reduction - Made in USA sales
 tax holiday

(More than
\$100,000)

(More than
\$100,000)

(More than
\$100,000)

**ESTIMATED NET EFFECT ON
 SCHOOL DISTRICT TRUST FUND**

**Unknown to
(More than
\$100,000)**

**Unknown to
(More than
\$100,000)**

**Unknown to
(More than
\$100,000)**

OTHER STATE FUNDS

Additional revenue - Department of
 Revenue - Collection procedures

Unknown

Unknown

Unknown

Revenue reduction - Section 144.190
 sales tax refunds

(More than
\$100,000)

(More than
\$100,000)

(More than
\$100,000)

**ESTIMATED NET EFFECT ON
 OTHER STATE FUNDS**

**Unknown to
(More than
\$100,000)**

**Unknown to
(More than
\$100,000)**

**Unknown to
(More than
\$100,000)**

<u>FISCAL IMPACT - Local Government</u>	FY 2013 (10 Mo.)	FY 2014	FY 2015
LOCAL GOVERNMENTS			
<u>Additional revenue</u> - Department of Revenue - Collection procedures	<u>Unknown</u>	<u>Unknown</u>	<u>Unknown</u>
<u>Revenue reduction</u> - Department of Revenue - One percent collection fee	<u>(Unknown)</u>	<u>(Unknown)</u>	<u>(Unknown)</u>
<u>Revenue reduction</u> - Section 144.55 sales tax exemption	<u>(More than \$100,000)</u>	<u>(More than \$100,000)</u>	<u>(More than \$100,000)</u>
<u>Revenue reduction</u> - Section 144.190 sales tax refunds	<u>(More than \$100,000)</u>	<u>(More than \$100,000)</u>	<u>(More than \$100,000)</u>
ESTIMATED NET EFFECT ON LOCAL GOVERNMENTS	<u>Unknown to (More than \$100,000)</u>	<u>Unknown to (More than \$100,000)</u>	<u>Unknown to (More than \$100,000)</u>

FISCAL IMPACT - Small Business

This proposal would have a fiscal impact on small business.

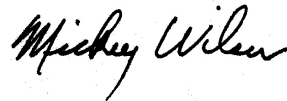
FISCAL DESCRIPTION

This proposal would reduce the tax on business income and corporate income, create a tax amnesty program, and allow the Department of Revenue to implement additional collection procedures for delinquent taxes. The proposal would also create a state debt collection program which the Department of Revenue would administer for the benefit of state agencies. The proposal would add a sales tax holiday for “Made in USA” products. Finally, the proposal would add a sales tax exemption for certain industrial inputs, and for certain inputs in food processing.

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
 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
City of Columbia
City of Kansas City
St. Louis County



Mickey Wilson, CPA
Director
May 2, 2012