COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 0619-01
Bill No.: HB 253
Subject: Business and Commerce; Taxation and Revenue - Income
Type: Original
Date: February 26, 2013

Bill Summary: This proposal would change provisions relating to the taxation of business income.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2014	FY 2015	FY 2016
General Revenue	($68,182,411)	($68,121,249 to $134,923,249)	($68,124,087 to $200,698,087)
Total Estimated Net Effect on General Revenue Fund	**($68,182,411)**	**($68,121,249 to $134,923,249)**	**($68,124,087 to $200,124,087)**

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2014	FY 2015	FY 2016
Total Estimated Net Effect on Other State Funds	**$0**	**$0**	**$0**

Numbers within parentheses: ( ) indicate costs or losses.
This fiscal note contains 15 pages.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2014	FY 2015	FY 2016
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2014	FY 2015	FY 2016
General Revenue	7 FTE	7 FTE	7 FTE
Total Estimated Net Effect on FTE	**7 FTE**	**7 FTE**	**7 FTE**

☒ 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 2014	FY 2015	FY 2016
Local Government	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

Officials from the **Office of the Secretary of State** assume this proposal would have no fiscal impact on their organization.

Officials from the **Joint Committee on Administrative Rules** assume that 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 any additional costs or savings to their organization.

Personal income tax

BAP officials noted that this proposal would phase in a deduction of business income from individual income tax, increasing from 10% in the first year, to 50% in the final year. The deductions would occur if the Office of Administration (OA) determines revenues have increased. If the average payroll of a particular business exceeds 150% of the county average wage, the full 50% deduction shall immediately apply.

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 are integral parts of the taxpayer's regular trade or business operations.

ASSUMPTION (continued)

BAP does not have data that specifically identifies taxable "business income". The IRS, in its Statistics of Income publication, provides the data for Missouri in the chart below from tax year 2010. BAP notes it is possible that Capital Gains or Dividend Income, as well as additional forms of income, could be included in business income in certain cases. BAP assumes that business income would exceed $10.5 billion. At the highest 6% marginal tax rate, the exclusion of 50% of business income could exceed $315 million, notwithstanding any inflationary growth.

Adjusted Gross Income ($Millions)	$135,415
Business Income	$3,960
Partnership Income	$6,565
Sub - total	$10,525
Ordinary Dividends	$3,295
Qualified Dividend	$2,680
Net Capital Gain	$3,803
Sub - total	$9,777
Total	$20,302

Oversight notes that the information provided by BAP indicates that business income from self-employed people and partnerships would equal $10,525 million, and the proposal would provide a maximum exclusion of 50% of that or ($10,525 million x 50%) = $5,262.50 million which would lead to a maximum personal income tax reduction of ($5,262,50 million x 6%) = $315.750 million.

Further, Oversight notes that if dividends and net capital gains are to be excluded from taxable income as well as self-employment and partnership income, then 50% of an additional $9,777 million or ($9,977 million x 50%) = $4,988.50 million would be excluded and personal income tax revenue would be reduced by an additional ($4,988.50 million x 6%) = $299.31 million. The total revenue reduction would then be ($315.750 million + $299.31 million) = $615.06 million.

ASSUMPTION (continued)

Corporate income tax

This proposal would reduce the corporate tax rate over five years, from 6.25% to 3.125%. The reductions would occur if the Office of Administration determines revenues have increased. If the average payroll of a particular business exceeds 150% of the county average wage, the full 50% deduction would immediately apply.

In FY 2012, $275.6M in net corporate taxes was received. Notwithstanding any inflationary growth, this proposal would reduce general and total state revenues as in the chart below:

Year	Tax rate	Revenues (millions)	Revenue reduction
FY 2012	6.250%	$275.60	$0.00
Year 1	5.625%	$248.00	$27.60
Year 2	5.000%	$220.50	$55.10
Year 3	4.375%	$192.90	$82.70
Year 4	3.750%	$165.40	$110.20
Year 5	3.125%	$137.80	$137.80

Officials from the **Department of Revenue (DOR)** assume this proposal would reduce the corporate income tax rate and would create a graduated deduction for personal business income.

DOR officials assume the Department would need to make form changes, and the Department and OA - ITSD (DOR) would need to make programming changes to various tax systems. DOR officials noted the proposal would provide different income tax rates and deductions in the same year based on whether or not the business pays more than the county average wage.

DOR officials assume the Department would need to make form changes and the Department and OA - ITSD (DOR) would need to make programming changes to various tax systems.

ASSUMPTION (continued)

Fiscal impact

DOR officials stated that for calendar year 2011, Missouri individual income tax filers reported $11.7 billion in "business" income of their federal form 1040s. The Department included the total reported on Schedule C, Schedule D, Schedule E and Schedule F in the calculation. Some portion of the $11.7 billion reported could have been earned outside the state of Missouri and would not have been taxable in Missouri. In addition, the $11.7 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 $11.7 billion in business income, and at the tax rate of 6 percent, the Department estimated the following reduction in individual income tax:

First year	$70.2 million
Second year	$140.4 million
Third year	$210.6 million
Fourth year	$280.8 million
Fifth year	$351.0 million

If any business income is subtracted at a rate of 50% in the manner provided in the proposal, the annual reductions noted above may be increased or decreased.

DOR officials also reported that for calendar year 2010, Missouri corporate taxpayers reported $5.6 billion in taxable income and $350 million in tax. Based on the estimated tax of $350 million, the Department estimates the following reduction in corporate income tax:

First year	$34 million
Second year	$70 million
Third year	$105 million
Fourth year	$140 million
Fifth year	$175 million

ASSUMPTION (continued)

Administrative impact

DOR officials assume that implementing this proposal would require additional employees. Personal Tax would require two additional Temporary Tax Employees for key entry; one additional FTE Revenue Processing Technician I (Range 10, Step L) per 19,000 additional errors; and one additional FTE Revenue Processing Technician I (Range 10, Step L) per 2,400 pieces of correspondence. Collections & Tax Assistance (CATA) would require one additional FTE Tax Collection Technician I (Range 10, Step L) per 15,000 additional contacts annually to the delinquent tax call center, plus CARES license and equipment; one additional FTE Tax Collection Technician I (Range 10, Step L) per 15,000 additional contacts annually to the non-delinquent call center, plus CARES license and equipment; and one additional FTE Revenue Processing Technician I (Range 10, Step L) per 4,800 additional contacts annually to the tax assistance offices plus CARES license and equipment for the Jefferson City tax assistance office. Corporate Tax would require one additional FTE Revenue Processing Technician I (Range 10, Step L) per 7,800 additional errors generated, plus CARES license and equipment; and one additional FTE Revenue Processing Technician I (Range 10, Step L) per 2,600 additional pieces of correspondence generated, plus CARES license and equipment.

The DOR estimate of cost to implement this proposal included two part-time employees and seven additional employees; with benefits, equipment, and expense, the DOR estimate totaled $301,123 for FY 2014, $302,023 for FY 2015, and $305,199 for FY 2016.

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 per 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 expense 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

DOR officials assume the IT cost to implement this proposal would be $54,533, based on 2,016 hours of programming to make changes to DOR systems.

Oversight will include the DOR estimate of IT cost in this fiscal note.

Officials from the **University of Missouri, Economic Policy Analysis and Research Center (EPARC)** assume this proposal would, if enacted, potentially reduce the corporate tax rate to 3.125% as well as potentially allow individual taxpayers to subtract 50% of their "business income" from their Federal Adjusted Gross Income when determining their Missouri adjusted Gross Income.

For tax years beginning on or after January 1, 2013, the 3.125% corporate tax rate and the 50% "business income" subtraction would be immediately available if average payroll for the business exceeds 150% of the county average wage in the county in which the business or corporation is located. For taxpayers that do not meet this average payroll requirement, the corporate tax rate reduction and the "business income" subtraction would be phased-in gradually based upon the growth of aggregate Missouri income tax collections beyond FY2011 levels.

EPARC officials stated they do not possess the data to discern which businesses or corporations meet the average payroll requirement, nor are they able to determine from which business or corporation any individual taxpayer derives their income. Therefore, we will proceed with this analysis by making two separate assumptions about the average payroll requirement that will yield two separate simulations. The first simulation will be based on the assumption that NO business or corporation is able to meet the average payroll requirement, and the second simulation will be based on the assumption that ALL businesses and corporations are able to meet the average payroll requirement. Our simulations will yield a maximum impact estimation.

ASSUMPTION (continued)

Personal income tax

We will begin by defining "business income," then summarize the manner in which this proposal would allow a phase-in of the corporate tax rate reduction and "business income" subtraction, and finally discuss our simulation findings. Business Income is assumed to be self-employment income. We estimate each taxpayer's self-employment income by dividing each filer's self-employment tax by their applicable tax rate as reported on their Federal 1040. Doing so, we estimate aggregate positive business income of $7,229,010,965 for 312,226 Missouri filers.

* In the first tax year that OA determines that aggregate income tax collections from the previous fiscal year are equal to or greater than collections for FY 2011, the corporate income tax rate would be reduced to 5.625% and a "business income" subtraction of 10% would be allowed.

* In the second tax year that OA determines that aggregate income tax collections from the previous fiscal year are indeed equal to or greater than FY 2011, the corporate income tax rate would be reduced to 5% and a "business income" subtraction of 20% would be allowed.

* In the third tax year that OA determines that aggregate income tax collections from the previous fiscal year are indeed equal to or greater than collections for FY 2011, the corporate income tax rate would be reduced to 4.375% and a "business income" subtraction of 30% would be allowed.

* In the fourth tax year that OA determines that aggregate income tax collections from the previous fiscal year are indeed equal to or greater than collections for FY 2011, the corporate income tax rate would be reduced to 3.75% and a "business income" subtraction of 40% would be allowed.

* In the fifth tax year that OA determines that aggregate income tax collections from the previous fiscal year are indeed equal to or greater than collections for FY 2011, the corporate income tax rate would be reduced to 3.125% and a "business income" subtraction of 50% would be allowed.

ASSUMPTION (continued)

Tax Year	Business Income Subtraction	Individual Income Tax Revenue	Reduction in Individual Income Tax Revenue
Baseline	0	$4,693.390	$0.000
Year 1	10%	$4,663.934	$29.456
Year 2	20%	$4,635.522	$57.868
Year 3	30%	$4,608.141	$85.249
Year 4	40%	$4,582.100	$111.290
Year 5	50%	$4,557.582	$135.808

Corporate income tax

Using the latest 2010 corporate income tax data as our baseline, where the aggregate liability is equal to $383.905 million, we find this aggregate liability would be reduced to $345.514 million in the first year OA determines that aggregate income tax collections from the previous fiscal year are indeed equal to or greater than FY 2011 and the corporate income tax rate is reduced to 5.625%, to $307.124 million in the second year when the corporate income tax rate is reduced to 5%, to $268.733 million in the third year when the corporate income tax rate is reduced to 4.375%, to $230.342 million in the fourth year when the corporate income tax rate is reduced to 3.75%, and to $191.952 million in the fifth year when the corporate income tax rate is reduced to 3.125%.

ASSUMPTION (continued)

Tax Year	Corporate Income Tax Rate	Corporate Income Tax Revenue	Reduction in Corporate Income Tax Revenue
Baseline	6.250%	$383.905	$0.000
Year 1	5.625%	$345.514	$38.391
Year 2	5.000%	$307.124	$76.781
Year 3	4.375%	$268.733	$115.172
Year 4	3.750%	$230.342	$153.563
Year 5	3.125%	$191.952	$191.953

Oversight notes that according to Department of Revenue records, personal and corporate income tax collections for FY 2012 were greater than collections for FY 2011. Accordingly, Oversight assumes this proposal would lead to a corporate tax rate reduction and a personal business income exclusion as provided in the proposal. Since the proposal would apply those changes to tax years beginning January 1, 2013, Oversight assumes those changes would be reflected in 2013 tax returns filed beginning January 1, 2014 (FY 2014).

For FY 2015 and FY 2016, the revenue reductions would be shown as a range from the reduction for FY 2014 to the maximum reduction computed by EPARC. The maximum rate reduction could be available in two ways; if all profitable employers paid more than the county average wage, or if actual collections for FY 213 and FY 2014 exceeded collections for FY 2011.

FISCAL IMPACT - State Government	FY 2014 (10 Mo.)	FY 2015	FY 2016
GENERAL REVENUE FUND			
Cost - Department of Revenue			
Salaries	($147,960)	($177,708)	($179,485)
Benefits	($75,082)	($90,178)	($91,080)
IT costs	($54,533)	$0	$0
Equipment and expense	($57,836)	($6,363)	($6,522)
Total cost - Department of Revenue	($335,411)	($274,249)	($277,087)
FTE change - DOR	7 FTE	7 FTE	7 FTE
Revenue reduction - corporate tax rate reduction Section 143.071	($38,391,000)	($38,391,000 to $76,781,000)	($38,391,000 to $115,172,000)
Revenue reduction - personal business income exclusion Section 143.031	($29,456,000)	($29,456,000 to $57,868,000)	($29,456,000 to $85,249,000)
ESTIMATED NET EFFECT ON GENERAL REVENUE FUND	**($68,182,411)**	**($68,121,249 to $134,923,249)**	**($68,124,087 to $200,698,087)**
Estimated FTE effect on General Revenue Fund	7 FTE	7 FTE	7 FTE

FISCAL IMPACT - Local Government	FY 2014 (10 Mo.)	FY 2015	FY 2016
	$0	**$0**	**$0**

FISCAL IMPACT - Small Business

This proposal would have a direct fiscal impact to small businesses which are subject to income tax.

FISCAL DESCRIPTION

This proposal would create the Broad-Based Tax Relief Act of 2013 which reduces the tax on corporate business income and business income for sole proprietors, partners, and shareholders in S-corporations.

For all tax years beginning on or after January 1, 2013, the amount of business income subject to tax would be determined by the Office of Administration comparing Missouri net individual and corporation income tax revenue received in the fiscal year ending on June 30, 2011, to Missouri net individual and corporation income tax revenues received in the fiscal year ending on June 30 of the tax year before the tax year of determination. If the result of the comparison shows a decrease from the 2011 year, the percentage of business income to be taxed would not change until the time that the comparison shows the revenues to be equal to or increased from 2011. Once the comparison shows the revenues to be equal to or increased, business income would be taxed at 90% for the year following the determination, then each year the comparison shows the revenues to be equal to or increased from 2011, business income would be taxed at 80%, then 70%, then 60%, and then 50% for each subsequent tax year.

FISCAL DESCRIPTION (continued)

For all tax years beginning on or after January 1, 2013, the corporate tax rate would be determined by the Office of Administration comparing Missouri net individual and corporation income tax revenue received in the fiscal year ending on June 30, 2011, to Missouri net individual and corporation income tax revenues received in the fiscal year ending on June 30 of the tax year before the tax year of determination. If the result of the comparison shows a decrease from the 2011 year, the corporate tax rate would remain the same until the time that the comparison shows the revenues to be equal to or increased from 2011. Once the comparison shows the revenues to be equal to or increased, the tax rate would be decreased from 6.25% to 5.625% for the year following the determination, then each year the comparison shows the revenues to be equal to or increased from 2011, the tax rate would decrease to 5%; then 4.375%, then 3.75% and finally to 3.125% for each subsequent tax year. Once a decrease occurs in the amount of the tax imposed, the tax rate cannot increase even if the sum of the Missouri net corporation income tax revenues and the Missouri net individual income tax revenues received in any following fiscal year ending on June 30 of any following tax year are less than the sum of the Missouri net corporation income tax revenues and the Missouri net individual income tax revenues received in the fiscal year ending on June 30, 2011. For all tax years beginning on or after January 1, 2013, if the average payroll for the tax year of a corporation exceeds 150% of the county average wage in the county in which the corporation is located the tax imposed upon the Missouri taxable income of corporations would be 3.125% of Missouri taxable income with specified exceptions.

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
Joint Committee on Administrative Rules
Office of Administration - Division of Budget and Planning
Department of Revenue
University of Missouri - Economic Policy and Analysis Research Center

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