

COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 4536-04
Bill No.: HCS for SCS for SB 823 with HA 1 and HA 2
Subject: Internet and E-mail; Taxation and Revenue - Sales and Use; Telecommunications;
 Taxation and Revenue - General; Economic Development
Type: Original
Date: May 4, 2016

Bill Summary: This proposal changes the laws regarding sales and use taxes.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2017	FY 2018	FY 2019
General Revenue	\$0 or (Up to \$520,700,000)	\$0 or (Up to \$624,900,000)	\$0 or (Up to \$624,900,000)
Total Estimated Net Effect on General Revenue	\$0 or (Up to \$520,700,000)	\$0 or (Up to \$624,900,000)	\$0 or (Up to \$624,900,000)

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2017	FY 2018	FY 2019
School District Trust	\$0 or (Up to \$173,600,000)	\$0 or (Up to \$208,300,000)	\$0 or (Up to \$208,300,000)
Conservation Commission	\$0 or (Up to \$21,700,000)	\$0 or (up to \$26,000,000)	\$0 or (Up to \$26,000,000)
Parks, and Soil & Water	\$0 or (Up to \$17,400,000)	\$0 or (Up to \$20,800,000)	\$0 or (Up to \$20,800,000)
Total Estimated Net Effect on <u>Other</u> State Funds	\$0 or (Up to \$212,700,000)	\$0 or (Up to \$255,100,000)	\$0 or (Up to \$255,100,000)

Numbers within parentheses: () indicate costs or losses. This fiscal note contains 9 pages.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2017	FY 2018	FY 2019
Total Estimated Net Effect on <u>All</u> Federal Funds			

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2017	FY 2018	FY 2019
Total Estimated Net Effect on FTE	0	0	0

Estimated Net Effect (expenditures or reduced revenues) expected to exceed \$100,000 in any of the three fiscal years after implementation of the act.

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2017	FY 2018	FY 2019
Local Government	\$0 or (\$27,400,000 to Unknown)	\$0 or (\$32,800,000 to Unknown)	\$0 or (\$32,800,000 to Unknown)

FISCAL ANALYSIS

ASSUMPTION

§144.026 - Production Exemption as amended with House Amendment 1:

Officials from the **B&P** assume this section will reduce Total State Revenue by \$880,000,000 and will impact the calculation under Article X, section 18(e).

This section exempts businesses from paying state and local sales and use taxes as allowed for in sections 144.030 and 144.054. The section expands production and manufacturing to include services and non-industrial production. This section also states that any court rulings, administrative hearings or letter rulings that are inconsistent with this section are invalid.

Since this section expands the definition of production to include activities that were not previously exempted and voids existing court law, B&P assumes that this section will eliminate all state sales taxes and local use taxes that non-retail businesses pay as final consumers. B&P cited a report made by the Council On State Taxation which shows that businesses paid \$2.2 billion in taxes to Missouri and local jurisdictions in FY 2014. Based upon this information, B&P estimates that this section will reduce Total State Revenue by \$733.4 million in FY 2017 and \$880 million in FY 2018 and thereafter. This would also reduce General Revenue by \$520.7 million in FY 2017 in FY 2017 and \$624.9 million in FY 2018 and thereafter.

This section also expands the local use tax exemptions in section 144.054, therefore, this would reduce local use tax collections by an estimated \$27.4 million in FY 2017 and \$32.8 million in FY 2018 and thereafter.

Officials from the **Department of Revenue (DOR)** state the legislation states that the exemptions in Sections 144.030.2(5) and (6) and 144.054.1 and 154.054.2 do not require that the "production activity" be "an industrial-type activity or that the activity occur in an industrial facility" and the exemptions apply "to all taxpayers and businesses whose activities meet the requirements of the production exemptions." It also states that in any decision of the Missouri Supreme Court, Administrative Hearing Commission, any letter ruling, or regulation of the Director of Revenue, including the Missouri supreme court case IBM Corporation v. Director of Revenue, that is inconsistent with this Section or Subdivisions (5) and (6) of Subsection 2 of Section 144.030 or Subsections 1 and 2 of Section 144.054 that case, ruling, or regulation are invalid. This Section is a clarification of existing law, and shall apply to all pending audits, assessments, refund claims, and claims for credit not yet finally adjudicated as well as all future audits, assessments, refund claims, and claims for credit.

ASSUMPTION (continued)

According to a report prepared by Price Waterhouse Cooper for the National Retail Federation, retail trade accounts for less than 20 percent of jobs and GDP. According to a report prepared by Ernst & Young for the Council on State Taxation, businesses pay approximately \$2.2 billion in state and local sales and use tax to Missouri each year. Sales and use taxes collected on sales to final consumers are excluded; only the taxes paid on businesses' operating inputs and capital equipment purchases are included in the total business tax estimates. Assuming about half of the tax paid is state tax and that 80 percent of the tax is paid by non-retailers, the Department estimates an impact to Total State Revenue of \$880 million. DOR assumed the loss broken out as:

General Revenue	\$597,000,000
Parks and Soils	\$ 23,000,000
Conservation	\$ 29,000,000
Education	<u>\$231,000,000</u>
TOTAL	\$880,000,000

Oversight notes the fiscal impact of this section (along with rulings of the Administrative Hearing Commission and the Missouri Supreme Court) is dependent upon interpretation:

- If the amendment is interpreted to reject and abrogate the Missouri Supreme Court Decision and puts the Department of Revenue's position back to where it was before the Administrative Hearing Commission's ruling, then Oversight assumes this section of proposal would not have a fiscal impact on current sales/use tax collections.
- If the amendment is interpreted to reject and abrogate the Missouri Supreme Court Decision and expand the manufacturing exemption for sales/use tax purposes, then Oversight assumes this amendment would result in expanded manufacturing exemptions and will result in a loss of sales/use tax revenue.

Oversight will range the fiscal impact from \$0 to the estimates provided by Budget and Planning.

§144.030 Internet and Email Access

In response to a prior version, officials at the **Department of Conservation, Department of Revenue, City of Columbia, City of Kansas City, Callaway County, Cass County, St. Louis County, Jackson County Election Board, Platte County Election Board, St. Louis County Election Board** each assumed no fiscal impact from the proposal.

Officials from the **Office of Administration - Budget and Planning (B&P)** assumed no fiscal impact. B&P noted this proposal would exempt internet and e-mail access from state and local sales and use tax, and further stated these are currently exempt from sales and use tax under federal law. Further, this proposal has no impact on Total State Revenue and is not subject to

ASSUMPTION (continued)

Article X, 18(e) calculations.

In response to a prior version, officials from the **Department of Natural Resources (DNR)** deferred to DOR and B&P for an account of the fiscal impact.

In response to a prior version, officials at the **City of Independence** assumed a material negative fiscal impact based upon their reading of the language in the proposal.

In response to a previous version, officials from the cities of **Gladstone, Grandview, Lee's Summit** and **Liberty** assumed a material negative fiscal impact based upon their reading of the language in the proposal.

Oversight will use the impact statements of DOR, B&P, MDC and DNR as well as the statement from the city of Kansas City, the St. Louis County of Director of Elections, Callaway County, Platte County and the Jackson County Election Board as the basis for this fiscal note.

Oversight has inquired with the U.S. Department of Commerce to confirm the federal law exemption but has not yet received a response to the inquiry.

§144.087 Retail Sales Tax

In response to a similar proposal (HB 2631), officials from the **Office of Administration-Division of Budget and Planning (OA-B&P)** noted that under current law, retail sales tax applicants must present a bond not more than three times their average monthly liability. This proposal diminishes that amount to no more than twice their average monthly liability. Additionally, the proposal reduces the bond release date from two years to one year.

OA-B&P assumed this proposal could decrease Total State Revenue by an unknown amount, which likely would be minimal.

In response to a similar proposal (HB 2631) officials from the **Department of Revenue**, the **Joint Committee on Administrative Rules** and the **Office of the Secretary of State** assumed no fiscal impact.

Oversight assumes a “minimal” reduction in General Revenue funds and will not show an amount in this fiscal note.

ASSUMPTION (continued)

§137.016 Bed and Breakfast (HA2)

Officials from the **Office of Administration-Division of Budget and Planning (B&P)** assume this section will reduce Total State Revenue by an unknown amount and will impact the calculation under Article X, section 18(e).

In response to a similar proposal (HB 2109) officials from the **Department of Natural Resources (DNR)** assumed the proposal would authorize a state and local sales tax exemption for a bed and breakfast inn in which the owner resides and does not exceed the limit of rooms requirement. DNR assumed the Department of Revenue and the Office of Administration-Division of Budget and Planning would provide a more detailed account of the fiscal impact.

Oversight assumes the proposal provides for a property tax reduction for certain owners of bed and breakfast establishments. **Oversight** notes that the proposal will not affect sales tax liability.

Oversight is providing an example of how the real estate taxes will be impacted by this proposal. Assuming the appraised value of a bed and breakfast which qualifies (owner resides and six or fewer rooms to rent) with an appraised value of \$500,000 would have an assessed value as commercial property (32% rate) of \$160,000 and using the average Missouri tax levy of \$5.48 would yield real estate property taxes of \$8,768. The same property reclassified as residential property (19% rate) would have an assessed value of \$95,000 and using the average Missouri tax levy of \$5.48 would yield real estate property taxes of \$5,206 (a reduction of \$3,562).

Oversight notes the reclassification from commercial real estate to residential real estate will reduce real estate taxes on that parcel by 40.625%.

The number of real estate parcels that qualify is unknown. The number of political subdivisions is unknown. The number of political subdivisions that currently operate under their authorized levy ceiling is unknown.

Oversight will show \$0 to (Unknown) as the amount of impact.

Oversight will assume the impact to the State's Blind Pension Trust Fund (\$0.03 levy) would be immaterial (\$19.50 in example shown above), and will not be reflected in the fiscal note.

In response to a similar proposal, officials from the **Department of Revenue**, the **Joint Committee on Administrative Rules** and the **State Tax Commission** assume no fiscal impact from the proposal.

<u>FISCAL IMPACT - State Government</u>	FY 2017 (10 Mo.)	FY 2018	FY 2019
GENERAL REVENUE FUND			
<u>Revenue reduction</u>			
§144.026-sales tax production exemption	\$0 or (Up to <u>\$520,700,000</u>)	\$0 or (Up to <u>\$624,900,000</u>)	\$0 or (Up to <u>\$624,900,000</u>)
ESTIMATED NET EFFECT ON GENERAL REVENUE FUND	<u>\$0 or (Up to \$520,700,000)</u>	<u>\$0 or (Up to \$624,900,000)</u>	<u>\$0 or (Up to \$624,900,000)</u>
SCHOOL DISTRICT TRUST FUND			
<u>Revenue reduction</u>			
§144.026-sales tax production exemption	\$0 or (Up to <u>\$173,600,000</u>)	\$0 or (Up to <u>\$208,300,000</u>)	\$0 or (Up to <u>\$208,300,000</u>)
ESTIMATED NET EFFECT ON SCHOOL DISTRICT FUND	<u>\$0 or (Up to \$173,600,000)</u>	<u>\$0 or (Up to \$208,300,000)</u>	<u>\$0 or (Up to \$208,300,000)</u>
CONSERVATION COMMISSION FUND			
<u>Revenue reduction</u>			
§144.026-sales tax production exemption	\$0 or (Up to <u>\$21,700,000</u>)	\$0 or (Up to <u>\$26,000,000</u>)	\$0 or (Up to <u>\$26,000,000</u>)
ESTIMATED NET EFFECT ON CONSERVATION FUND	<u>\$0 or (Up to \$21,700,000)</u>	<u>\$0 or (Up to \$26,000,000)</u>	<u>\$0 or (Up to \$26,000,000)</u>
PARKS, AND SOIL AND WATER FUND			
<u>Revenue reduction</u>			
§144.026-sales tax production exemption	\$0 or (Up to <u>\$17,400,000</u>)	\$0 or (Up to <u>\$20,800,000</u>)	\$0 or (Up to <u>\$20,800,000</u>)
ESTIMATED NET EFFECT ON PARKS, AND SOIL AND WATER FUND	<u>\$0 or (Up to \$17,400,000)</u>	<u>\$0 or (Up to \$20,800,000)</u>	<u>\$0 or (Up to \$20,800,000)</u>

<u>FISCAL IMPACT - Local Government</u>	FY 2017 (10 Mo.)	FY 2018	FY 2019
LOCAL GOVERNMENTS			
<u>Revenue Reduction</u> - B&B Property Tax Revenue §137.016	\$0 to (Unknown)	\$0 to (Unknown)	\$0 to (Unknown)
<u>Revenue Reduction</u> - Use Tax Revenue §144.026	\$0 or (\$27,400,000 to <u>Unknown</u>)	\$0 or (\$32,800,000 to <u>Unknown</u>)	\$0 or (\$32,800,000 to <u>Unknown</u>)
ESTIMATED NET EFFECT ON LOCAL GOVERNMENTS	\$0 or (\$27,400,000 to <u>Unknown</u>)	\$0 or (\$32,800,000 to <u>Unknown</u>)	\$0 or (\$32,800,000 to <u>Unknown</u>)

FISCAL IMPACT - Small Business

Small businesses engaged in the bed and breakfast business would be impacted by this proposal.

Small businesses which qualify for the production exemption would be expected to benefit as a result of this proposal.

FISCAL DESCRIPTION

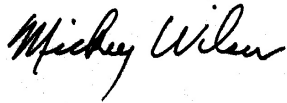
The proposed legislation changes the classification of a bed and breakfast inn in which the owner resides and has six or less rooms for rent from commercial property to residential property for taxation purposes.

The proposed legislation may provide for an expanded sales tax production exemption.

This legislation is not federally mandated, would not duplicate any other program and would not require additional capital improvements or rental space.

SOURCES OF INFORMATION

Department of Revenue
Office of Administration -
 Budget and Planning
Department of Conservation
Department of Natural Resources
City of Kansas City
Cass County
Callaway County
St. Louis County
Platte County Election Board
Jackson County Election Board
St. Louis County Election Board
City of Columbia
City of Gladstone
City of Grandview
City of Independence
City of Lee's Summit
City of Liberty



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