COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 3456-01
Bill No.: SB 640
Subject: Taxation and Revenue - Income
Type: Original
Date: January 27, 2020

Bill Summary: This proposal increases the amount of the personal income tax cut and the business income deduction in current law.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND				
FUND AFFECTED	FY 2021	FY 2022	FY 2023	Fully Implemented (FY 2025)
General Revenue	Up to ($85,689,683)	Up to ($250,524,179)	Up to ($368,552,410)	Up to ($475,052,760)
Total Estimated Net Effect on General Revenue	**Up to ($85,689,683)**	**Up to ($250,524,179)**	**Up to ($368,552,410)**	**Up to ($475,052,760)**

ESTIMATED NET EFFECT ON OTHER STATE FUNDS				
FUND AFFECTED	FY 2021	FY 2022	FY 2023	Fully Implemented (FY 2025)
Total Estimated Net Effect on Other State Funds	**$0**	**$0**	**$0**	**$0**

Numbers within parentheses: ( ) indicate costs or losses. This fiscal note contains 11 pages.

ESTIMATED NET EFFECT ON FEDERAL FUNDS				
FUND AFFECTED	FY 2021	FY 2022	FY 2023	Fully Implemented (FY 2025)
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)				
FUND AFFECTED	FY 2021	FY 2022	FY 2023	Fully Implemented (FY 2025)
Total Estimated Net Effect on FTE	**0**	**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 2021	FY 2022	FY 2023	Fully Implemented (FY 2025)
Local Government	**$0**	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

Section 143.011 - Reduction(s) to Top Individual Income Tax Rate(s)

Officials from the **Office of Administration - Budget & Planning Division (B&P)** state this proposed legislation would end the current rate reductions created under SB 509 (2014) after three reductions. B&P notes that there have been two reductions (Tax Year(s) 2018 and 2019) so far. B&P further notes that the tax rate reduction was not triggered for Tax Year 2020. For the purpose of this fiscal note, B&P will assume that the third reduction will be triggered for Tax Year 2021.

Oversight notes this proposed legislation would reduce the current amount of reductions allowed under this section created by SB 509 (2014) from a total of five (5) reductions to three (3) reductions. Oversight notes the tax rate was reduced for Tax Year 2018 from 6% to 5.9%. The tax rate was again reduced for Tax Year 2019 from 5.9% to 5.4% (includes a .4% reduction from HB 2540/2018). A tax rate reduction was not triggered for Tax Year 2020 and remains at 5.4%. For the purposes of this fiscal note, Oversight will assume the third rate reduction created under SB 509 (2014) would occur for Tax Year 2021, and the additional rate reductions proposed would follow each consecutive tax year.

B&P further notes this proposed legislation would create additional top rate reductions beginning Tax Year 2021. The top rate of tax may be reduced by 0.2% each year net general revenue collected in the previous fiscal year exceeds the highest amount of net general revenue collected in any of the three previous fiscal years by at least $150 million. The aggregate amount of reductions shall not exceed 0.7%. Table 1 shows the tax rate changes under this proposal.

Table 1: Tax Rates

Tax Year	Current Law	Proposal
2018	5.90%	5.90%
2019	5.40%	5.40%
2020	5.40%	5.40%
2021*	5.30%	5.10%
2022*	5.20%	4.90%
2023*	5.10%	4.70%

*Assumes growth triggers occur in consecutive years

ASSUMPTION (continued)

B&P notes that Section 143.011.4 would allow for a maximum total reduction in the top tax rate of 0.7% under subsection 4. However, each reduction is equal to 0.2%; therefore, only 0.6% in total reductions will occur under this subsection.

Oversight notes the proposed legislation allows for tax rate reduction for each tax year so long as the net general revenue collected in the previous fiscal year exceeds the highest amount of net general revenue collected in any of the three previous fiscal years by at least $150 million. The reductions proposed would be equal to one-fifth of one percent, or .2%. Furthermore, the proposed legislation states the total amount of reductions may not exceed seven-tenths of one percent or .7%. Oversight assumes the maximum amount of reductions that could occur under this proposed legislation would be three total reductions over the course of three tax years. Oversight assumes the proposed legislation mentions the total amount of reductions may not exceed seven-tenths of one percent (.7%) as it is taking into consideration the .1% reduction that would still be allowable under SB 509 (2014). Oversight will assume the triggers will be met each consecutive year warranting a rate reduction as proposed.

Oversight notes the current top individual income tax rate per tax year is (assuming the rate reductions created under SB 509 (2014) occur in Tax Year 2021, 2022 and 2023):

Current Tax Rates	
Tax Year	**Rate**
2020	5.4%
2021	5.3%
2022	5.2%
2023	5.1%

Oversight notes the top individual income tax rate per tax year, as proposed, would be (assuming the triggers required are met each consecutive tax year):

Projected Tax Rates	
Tax Year	**Rate**
2020	5.40%
2021	5.10%
2022	4.90%
2023	4.70%

Oversight notes Tax Year 2021 includes the third and final reduction created under SB 509 (2014) as well as a .2% reduction. Tax Year 2022 and 2023 both recognize a .2% reduction.

ASSUMPTION (continued)

Officials from the **Missouri Department of Revenue (DOR)** state this proposed legislation is updated to reduce the number of reductions allowed pursuant to subsection 2 of this section. The amount of reductions allowed pursuant to the aforementioned is currently five. This proposed legislation would allow no more than three reductions.

This proposed legislation adds a new section 4. The proposed section 4 states that, in addition to the rate reductions under subsection 2 and 3 of this section, beginning with the 2021 calendar year the top rate of tax under subsection 1 of this section may be reduced over a period of years. Each reduction in the top rate of tax shall be by one-fifth of one percent (.2%) and no more than one reduction shall occur in a calendar year. The aggregate amount of reductions made under this subsection shall not exceed seven-tenths of one percent (.7%). Any reduction in the rate of tax shall only occur if the amount of net general revenue collected in the previous fiscal year exceeds the highest amount of net general revenue collected in any of the three fiscal years prior to such fiscal year by at least one hundred fifty million dollars ($150 million).

Oversight notes this proposed legislation allows for one final rate reduction as set forth under current law created under SB 509 (2014) equal to one-tenth of one percent (.1%). Oversight assumes the triggers required to be met for the tax rate reduction to take place will occur for Tax Year 2021. Furthermore, this proposed legislation allows for an additional reduction of one-fifth of one percent (.2%) during Tax Year 2021. Oversight notes the proposed legislation would allow for an additional .2% reduction to the top rate of tax for Tax Year 2022 and Tax Year 2023. Oversight will assume the triggers required in order for the rate reductions to occur will be met each consecutive year.

Officials from the **University of Missouri's Economic & Policy Analysis Research Center (EPARC)** assume this bill retains the third rate adjustment from SB 509 (2014), a third and final reduction in the top individual income tax rate of 0.1%. EPARC assumes this final rate reduction will occur in 2021.

This bill creates a new top individual income tax rate reduction plan. It would increase the personal income tax cut by an additional 0.1%. Current law states that when a revenue threshold is met, the top personal income tax rate will be cut by one-tenth of one percent (.1%) the following tax year. This bill would increase this cut to one-fifth of one percent (.2%)

Section 143.022 - Pass-Through Business Income Subtraction

Officials from **B&P** state this proposed legislation would increase the amount of pass-through business income exempt from individual income tax from 5% increments to 10% increments, beginning with Tax Year 2021. B&P notes that the current pass-through business exemption was 5% in Tax Year 2018 and has increased to 10% for Tax Year 2019. B&P further notes that an additional increase was not triggered for Tax Year 2020. Table 2 shows the pass-through business exemption under this proposal.

ASSUMPTION (continued)

Table 2: Pass-through Business Exemption

Tax Year	Current Law	Proposal
2018	5%	5%
2019	10%	10%
2020	10%	10%
2021*	15%	20%
2022*	20%	30%
2023*	20%	40%
2024*	20%	50%

Oversight notes this proposed legislation increases the interval amounts of business income that may be subtracted from a taxpayer's Missouri Adjusted Gross Income each year from five percent (5%) to ten percent (10%) each year (provided the appropriate triggers are met). In addition, this proposed legislation increases the maximum percentage allowed to be subtracted and would, when fully implemented in Tax Year 2024, allow taxpayers to subtract fifty percent (50%) of the qualifying income rather than twenty percent (20%) as allowable under current law.

Officials from **DOR** state this proposed legislation updates subsection 4 of this section. Subsection 4 is updated to read "for all tax years beginning on or after January 1, 2017 and beginning on or before December 31, 2020", each increase in the percentage shall be by five percent (5%) and no more than one increases shall occur in one year. For all tax years beginning on or after January 1, 2021, each increase in the percentage shall be by ten percent, and no more than one increase shall occur in a calendar year.

The maximum percentage that may be subtracted is increased from twenty to fifty percent of business income.

Oversight notes the amount allowed to be subtracted each year is increased to ten percent (10%), rather than five percent (5%) as stated in current law. In addition, the maximum percent to be subtracted is increased from twenty percent (20%) to fifty percent (50%).

Officials from **EPARC** state this bill would increase the business income deduction by 5%. Current law states that when a revenue threshold is met, the business income deduction will be increased by 5% the following tax year. This bill would allow, when the revenue threshold is met, the business income deduction to be increased by 10% the following year.

ASSUMPTION (continued)

Summary - The estimates below include the combined estimated revenue changes from the reduction of the top individual income tax rate and the increase in the pass-through business income subtraction.

B&P, for the purpose of this fiscal note, assumes the income tax rate reductions and business income exemptions scheduled to occur under current law and under this proposal will happen in consecutive years from Tax Year 2021 through Tax Year 2024.

Using Tax Year 2017 data, the most recent complete tax year available, and accounting for the changes in individual income tax law created by SB 509 (2014), HB 2540 (2018) and the Tax Cuts and Jobs Act (2017), B&P estimates that this section will reduce Total State Revenue (TSR) and General Revenue (GR) by $202.3M in Tax Year 2021. Once fully implemented in Tax Year 2024, this section will reduce TSR and GR by $463.1M. Table 3 shows the impact from this section by calendar year.

Table 3: Estimated Impact **by Tax Year**

Tax Year	GR Loss
2021	($202,250,968)
2022	($311,160,370)
2023	($435,343,120)
2024	($463,081,531)

*Assumes growth triggers occur in consecutive years

However, because this proposal would take effect January 1, 2021, individuals will adjust their withholdings and declarations during Fiscal Year 2021. Based on actual collections data, B&P estimates that 42% of individual income taxes are paid during fiscal year 1 and 58% are paid during fiscal year 2. Therefore, B&P estimates that this proposal will reduce TSR and GR by $84.9M in Fiscal Year 2021. Once fully implemented in Fiscal Year 2025, and annually thereafter, this proposal will reduce TSR and GR by $463.1M. Table 4 shows the estimated impact from this section by fiscal year.

Table 4: Estimated Impact **by Fiscal Year**

Fiscal Year	GR Loss
2021	($84,945,407)
2022	($247,992,917)
2023	($363,317,125)
2024	($446,993,253)
2025	($463,081,531)

*Assumes growth triggers occur in consecutive years

ASSUMPTION (continued)

Officials from **DOR** used its internal Income Tax Model that contains confidential taxpayer data to create the fiscal impact. DOR believes that the tax rates, as proposed, could become as follows:

Tax Year	Current Income Tax Rate	Current Business Income Rate	Proposed Income Tax Rate	Proposed Business Income Rate
2018	5.90%	5%	5.90%	5%
2019	5.40%	10%	5.40%	10%
2020	5.40%	10%	5.40%	10%
2021	5.30%	20%	5.10%	20%
2022	5.20%	20%	4.90%	30%
2023	5.10%	20%	4.70%	40%
2024	5.10%	20%	4.70%	50%

DOR assumes the impact to GR per calendar/tax year is as follows:

Tax Year	Impact
TY 2021	($204,023,055)
TY 2022	($314,740,018)
TY 2023	($442,864,762)
TY 2024	($475,052,760)

DOR uses a 42% in the first year and 58% in the second year split when converting from tax (calendar) year to fiscal year. The impact per Fiscal Year is as follows:

Fiscal Year	Impact to General Revenue
FY 2021	($85,689,683)
FY 2022	($250,524,179)
FY 2023	($368,552,410)
FY 2024	($456,383,721)

ASSUMPTION (continued)

Officials from **EPARC** assume in Tax Year 2021 the parameters of this bill will reduce revenue by $223.235 million. Therefore, in Fiscal Year 2022, EPARC would expect a loss in GR of $223.235 million due to this bill.

In Tax Year 2022 EPARC estimates the parameters of this bill will reduce revenue by $344.966 million. Therefore, in Fiscal Year 2023, EPARC would expect a loss in GR of $344.966 million due to this bill.

In Tax Year 2023, EPARC estimates the parameters of this bill will reduce revenue $463.208 million. Therefore, in Fiscal Year 2024, EPARC would expect a loss in GR of $463.208 million due to this bill.

Oversight does not currently have the resources and/or access to state tax data to produce an independent revenue analysis or estimate and is unable to verify the revenue estimates provided by B&P and DOR.

For the purposes of this fiscal note, Oversight will use DOR's estimates for Fiscal Year(s) 2021, 2022, 2023 and Oversight's estimate having extrapolated DOR's estimate out to show the fully implemented impact for Fiscal Year 2025.

FISCAL IMPACT - State Government	FY 2021	FY 2022	FY 2023	Fully Implemented (FY 2025)
GENERAL REVENUE FUND				
Revenue Reduction - Section 143.011 and 143.022 - Income Tax Rate Reduction and Increase in Business Income Pass Through Subtraction Percentage p. 7-9	Up to ($85,689,683)	Up to ($250,524,179)	Up to ($368,552,410)	Up to ($475,052,760)
ESTIMATED NET EFFECT ON GENERAL REVENUE	**Up to ($85,689,683)**	**Up to ($250,524,179)**	**Up to ($368,552,410)**	**Up to ($475,052,760)**

FISCAL IMPACT - Local Government	FY 2021	FY 2022	FY 2023	Fully Implemented (FY 2025)
	$0	**$0**	**$0**	**$0**

FISCAL IMPACT - Small Business

Small businesses could pay less in Missouri income tax as a result of this proposal.

FISCAL DESCRIPTION

Current law provides for a reduction in the top rate of income tax over a period of years from 6% to 5.5%, with each cut becoming effective if net general revenue collections meet a certain trigger. This act increases the amount by which the top rate will be reduced. Each year the trigger is met, the top rate will be reduced by 0.2% rather than 0.1%, and the aggregate amount of reductions to be made, including reductions already made and reductions made under this act, shall not exceed 1.0%. (Section 143.011)

Currently, a business income deduction is being phased in over a period of years. Each year that a general revenue growth trigger is met, the deduction amount is increased by 5%. Once fully phased in, individual taxpayers may deduct up to 20% of their business income. This act increases the amount that may be deducted. Each year that the trigger is met, the deduction amount will be increased by 10%. Once fully phased in, individual taxpayers may deduct up to 50% of their business income. (Section 143.022)

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 Administration - Budget & Planning Divisions
Missouri Department of Revenue
Missouri University's Economic & Policy Analysis Research Center

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January 27, 2020

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January 27, 2020