COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 1667S.01I
Bill No.: SB 448
Subject: Taxation and Revenue - Income
Type: Original
Date: January 10, 2023

Bill Summary: This proposal modifies provisions relating to income tax exemptions for certain retirement benefits.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2024	FY 2025	FY 2026
General Revenue	$0	Up to ($318,774,509)	Up to ($318,774,509)
Total Estimated Net Effect on General Revenue	**$0**	**Up to ($318,774,509)**	**Up to ($318,774,509)**

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2024	FY 2025	FY 2026
Total Estimated Net Effect on Other State Funds	**$0**	**$0**	**$0**

Numbers within parentheses: () indicate costs or losses.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2024	FY 2025	FY 2026
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2024	FY 2025	FY 2026
Total Estimated Net Effect on FTE	**0**	**0**	**0**

☒ Estimated Net Effect (expenditures or reduced revenues) expected to exceed $250,000 in any of the three fiscal years after implementation of the act or at full implementation of the act.

☐ Estimated Net Effect (savings or increased revenues) expected to exceed $250,000 in any of the three fiscal years after implementation of the act or at full implementation of the act.

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2024	FY 2025	FY 2026
Local Government	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

Section 143.124 & 143.125 Retirement Benefit

Officials from the **Department of Revenue** note currently some retirement benefits are subtracted from a taxpayer's adjusted gross income for determining taxable income. State, federal and local government pensions are public pensions and when calculating taxable income, based on certain income limits part of the taxpayer's public pensions are not taxable. Additionally, some social security benefits are not considered taxable when determining taxable income. These subtractions phase out at $85,000 for single and HOH filers and phase out at $100,000 for married filing combined filers.

This proposal broadens that subtraction by removing the current income limits and allow all public pension and social security retirement income to be excluded from the calculation of taxable income.

The Department notes this additional subtraction begins January 1, 2024 (FY 2025 based on when the tax returns are filed).

Using their internal Individual Income Tax Database for Missouri, DOR found the following distribution of filers of public and private pensions.

Pensions	Public	Private
Singles	39%	61%
Married Filing Joint	49%	51%
Head of Household (HOH)	42%	58%

DOR then used information reported by taxpayers on their federal returns to calculate the amount of additional revenue that would be exempt from tax. DOR notes that SB 3 (2022) will set the individual income tax rate at 4.95% starting in tax year 2023. After that, it will continue to reduce the tax rate over a period of several years until the rate equals 4.5%. At that time, it will remain at 4.5%. For fiscal note purposes only, DOR will show the loss at each of those tax rates. This will result in a loss to general revenue.

Retirement Income	Top Tax Rate				
	4.95%	4.8%	4.7%	4.6%	4.5%
Pensions/Annuities (Public)	($159,619,564)	($154,782,607)	($151,557,970)	($148,333,332)	($145,108,694)
Social Security	($159,154,945)	($154,332,068)	($151,116,816)	($147,901,565)	($144,686,314)
Total GR Loss	($318,774,509)	($309,114,675)	($302,674,786)	($296,234,897)	($289,795,008)

Administrative Impact
This proposal would require modification to the MO-A form and to the MO-1040P form. Additionally DOR will need to modify their website and individual income tax computer system. These changes are estimated to cost $7,193.

At this time, the Department believes it can handle this work with existing resources. However, should DOR reach the number of errors or correspondence to justify additional FTE from this proposal or in combination with other proposals that will pass; DOR will seek the required number of FTE through the appropriation process. The Department is providing the number of errors or correspondence that require additional FTE.

1 FTE Associate Customer Service Rep for every 14,700 errors created
1 FTE Associate Customer Service Rep for every 5,700 pieces of correspondence generated

Oversight notes that the Department of Revenue assumes this proposal will require programming changes estimating $7,193. Oversight assumes DOR is provided with core funding to handle a certain amount of activity each year. Oversight assumes DOR could absorb the computer upgrade costs related to this proposal. Should the department reach the number of errors or correspondence to justify additional FTE from this proposal or in combination with other proposals that will pass; DOR could seek the required number of FTE through the appropriation process. If multiple bills pass which require additional staffing and duties at substantial costs, DOR could request funding through the appropriation process.

Officials from the **Office of Administration - Budget and Planning (B&P)** note Section 143.124 would eliminate the income limits for the individual income tax exemption for public pensions beginning with tax year 2024. Currently, taxpayers who are married filing joint may exempt 100% of their public pension income, if their Missouri Adjusted Gross Income (MAGI) is equal to or less than $100,000. All other taxpayers may exempt 100% of their public pension income if their MAGI is equal to or less than $85,000.

In order to estimate the potential impact from this provision, B&P utilized pensions and annuity data published by the IRS. However, B&P notes that the term "pensions and annuities" includes both public and private retirement funds. For the purpose of this fiscal note, B&P used tax year 2020 (the most recent complete year available) Missouri tax return data to estimate the percentage of payments from public pensions and annuities versus private pensions and annuities.

In tax year 2020, 61% of pension and annuity payments were from private funds and 39% were from public funds for individuals filing single. For married filing combined individuals, 51% of payments were from private funds, while 49% were from public funds. For taxpayers filing as head of household, 58% of pension and annuity payments were from private sources, while 42% were from public sources.

Based on data published by the IRS, B&P estimates that this provision may exempt up to $529,569,030 in public pension and annuity payments for taxpayers filing single, $144,198,054 for taxpayers filing head of household, and $2,550,768,784 for married filing joint taxpayers; for a total of up to $3,224,535,868 in public pension and annuity income exempted under this provision.

However, exemptions do not reduce revenues on a dollar for dollar basis, but rather in proportion to the top tax rate applied. Therefore, B&P will show the estimated impacts throughout the implementation of the tax rate reductions from SB 3 (2022).

Consequently, B&P estimates that exempting public pension and annuity payments could reduce TSR and GR by $159,614,525 (top tax rate 4.95%) or by $154,777,722 (top tax rate 4.8%) in FY25. Once SB 3 (2022) has fully implemented, this provision could reduce TSR and GR by $145,104,114 annually.

B&P also notes Section 143.125 would eliminate the income limits for the individual income tax exemption for social security payments beginning with tax year 2024. Currently, taxpayers who are married filing joint may exempt 100% of their social security income, if their Missouri Adjusted Gross Income (MAGI) is equal to or less than $100,000. All other taxpayers may exempt 100% of social security income if their MAGI is equal to or less than $85,000.

Based on data published by the IRS, B&P estimates that this section may exempt $689,197,344 in social security payments for taxpayers filing single, $172,665,756 for taxpayers filing head of household, and $2,353,388,312 for married filing joint taxpayers; for a total of $3,215,251,412 in income exempted under this section.

However, exemptions do not reduce revenues on a dollar for dollar basis, but rather in proportion to the top tax rate applied. Therefore, B&P will show the estimated impacts throughout the implementation of the tax rate reductions from SB 3 (2022).

B&P estimates that this section could reduce TSR and GR by $159,154,945 (top tax rate 4.95%) or by $154,332,068 (top tax rate 4.8%) in FY25. Once SB 3 (2022) has fully implemented, this section could reduce TSR and GR by $144,686,314 annually.

<u>Summary</u>
B&P estimates that this proposal in total could reduce TSR and GR by $318,769,470 (top tax rate 4.95%) or by $309,109,790 (top tax rate 4.8%) in FY25. Once SB 3 (2022) has fully implemented, this proposal could reduce TSR and GR by $289,790,428 annually. Table 1 shows the estimated loss by provision, while Table 2 shows the estimated loss by tax and fiscal year.

Table 1: Revenue Loss by Provision

Retirement Income	Top Tax Rate				
	4.95%	4.8%	4.7%	4.6%	4.5%
Pensions/Annuities	$159,614,525	$154,777,722	$151,553,186	$148,328,650	$145,104,114
Social Security	$159,154,945	$154,332,068	$151,116,816	$147,901,565	$144,686,314
Total GR Loss	$318,769,470	$309,109,790	$302,670,002	$296,230,215	$289,790,428

Table 2: Revenue Loss by Fiscal Year

	Tax Year (Fiscal Year)				
Tax Rate	2024 (FY25)	2025 (FY26)	2026 (FY27)	2027 (FY 28)	2028 (FY29)
4.95%	$318,769,470	$318,769,470	$318,769,470	$318,769,470	$318,769,470
4.80%	$309,109,790	$309,109,790	$309,109,790	$309,109,790	$309,109,790
4.70%		$302,670,002	$302,670,002	$302,670,002	$302,670,002
4.60%			$296,230,215	$296,230,215	$296,230,215
4.50%				$289,790,428	$289,790,428

Officials from the **Joint Committee on Administrative Rules** assume the proposal will have no fiscal impact on their organization. **Oversight** does not have any information to the contrary.

Oversight assumes JCAR will be able to administer any rules from this proposed legislation with existing resources.

Officials from the **Office of the Secretary of State (SOS)** note 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 $5,000. The SOS recognizes that this is a small amount and does not expect that additional funding would be required to meet these costs. However, the SOS also recognizes 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 the office can sustain with its core budget. Therefore, the SOS reserves 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.

Oversight assumes the SOS could absorb the costs of printing and distributing regulations related to this proposed legislation. If multiple bills pass which require the printing and distribution of regulations at substantial costs, the SOS could request funding through the appropriations process.

Oversight notes DOR’s estimates include data from their internal Income Tax Model.

Oversight notes that it does not currently have the resources and/or access to state tax data to produce a thorough independent revenue estimate and is unable to verify the revenue estimates provided by DOR.

Oversight will utilize DOR's projected fiscal estimated impacts of this proposal throughout the implementation of the tax rate reductions from SB 509 (2014), SB 153 (2021), and SB 3 (2022) to show the maximum low and high impact of the proposal.

FISCAL IMPACT – State Government	FY 2024 (10 Mo.)	FY 2025	FY 2026
GENERAL REVENUE			
Revenue Reduction – §143.124 & §143.125 Allowance of maximum deduction to all taxpayers	$0	Up to ($318,774,509)	Up to ($318,774,509)
ESTIMATED NET EFFECT ON GENERAL REVENUE	**$0**	**Up to ($318,774,509)**	**Up to ($318,774,509)**

FISCAL IMPACT – Local Government	FY 2024 (10 Mo.)	FY 2025	FY 2026
	$0	**$0**	**$0**

FISCAL IMPACT – Small Business

No direct fiscal impact to small businesses would be expected as a result of this proposal.

FISCAL DESCRIPTION

Current law allows taxpayers with certain filing status and adjusted gross income below certain thresholds to deduct 100% of certain retirement and Social Security benefits from the taxpayer's Missouri adjusted gross income, with a reduced deduction as the taxpayer's adjusted gross income increases. For all tax years beginning on or after January 1, 2024, this act allows the maximum deduction to all taxpayers regardless of filing status or adjusted gross income.

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 the Secretary of State
Joint Committee on Administrative Rules
Office of Administration - Budget and Planning

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