COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 5287S.01I
Bill No.: SB 1365
Subject: Taxation and Revenue - Income
Type: Original
Date: April 16, 2024

Bill Summary: This proposal authorizes an income tax deduction for certain research expenses.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2025	FY 2026	FY 2027
General Revenue*	(Unknown, could be substantial)	(Unknown, could be substantial)	(Unknown, could be substantial)
Total Estimated Net Effect on General Revenue	**(Unknown, could be substantial)**	**(Unknown, could be substantial)**	**(Unknown, could be substantial)**

*Per the Department of Revenue, should the Federal Tax Relief for American Families and Workers Act of 2024 (H.R. 7024) be signed into law, then SB 1365 would become moot.

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2025	FY 2026	FY 2027
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 2025	FY 2026	FY 2027
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2025	FY 2026	FY 2027
General Revenue - DOR	1 FTE	1 FTE	1 FTE
Total Estimated Net Effect on FTE	**1 FTE**	**1 FTE**	**1 FTE**

☒ 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 2025	FY 2026	FY 2027
Local Government	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

Section 143.121 Qualified Research Income Tax Addition/Subtraction

Officials from the **Department of Revenue (DOR)** note under federal law a business is allowed to subtract from their Federal Adjusted Gross Income (FAGI) some of their qualified research expenses allowed per 26 U.S.C Section 174(a)(2)(B). The starting line on the Missouri individual income tax return is your FAGI number. Any deductions or subtractions at the federal level, means less taxable income on the Missouri Return.

This proposal would require those same businesses to add the deducted income back into their FAGI for calculating their Missouri adjusted gross income (MAGI). Then the proposal allows the same business to subtract their entire qualified research expenditures that are charged to a capital account.

This proposal is to become effective starting August 28, 2024. However, this proposal is backdating these changes to January 1, 2022. The backdating of the changes will require businesses to file amended returns. DOR assumes these amended returns will be received after August 2024, and therefore the first fiscal impact will be in FY 2025.

This proposal is in response to changes made regarding the reporting of qualified research expenditures under the Tax Cuts & and Jobs Act (TCJA). Prior to the passage of the TCJA in December 2017, businesses were allowed to decide how they wanted to report their qualified research expenditures. They could deduct their total expenses in a single year or amortize the expenses over a period of years. DOR notes that a provision in the TCJA prohibits the full deduction in year 1. Implementation of this provision went into effect starting January 1, 2022. Businesses now must amortize over time. Per numerous articles and reports written, most businesses choose to do the deduction in the first year.

When a business is allowed to remove the qualified research expenditures from their federal taxable income in a single year, it results in the business having a smaller tax liability in Missouri. The starting point on the Missouri tax return is with your FAGI. By having the businesses place all their income back onto the Missouri the department will be able to see what was reported before. Then allowing them the subtraction, will allow them to deduct their expenses in a single year, lowering their taxable income in Missouri.

DOR was unable to provide a single source on the amount of qualified research expenditures reported. DOR is also unable to predict the number of companies or the amount of expenses they will claim. This could potentially result in a loss to general revenue of over $1,000,000.

This proposal creates a new addition and subtraction that would require 2 new lines being added to the Form MO-A ($7,138), updates to the department's website and changes to the individual income tax computer system ($1,785). These changes are estimated to cost $8,923. DOR's existing tax credit staff is no longer able to take on any additional additions and subtractions without additional resources. Due to the intensive knowledge of what will qualify as an allowed expense means DOR is not able to use temporary staff to help with processing these returns. This proposal would require at least 1 FTE Associate Customer Service Rep at a salary of $35,880.

During the preparation of the fiscal note, it was announced that the U.S. House of Representatives had passed the Tax Relief for America Families and Workers Act of 2024. This Act contains the language needed to fix this issue at the federal level starting January 1, 2022. Should this Act be signed into law, then SB 1365 would become moot.

Officials from the **Office of Administration - Budget and Planning (B&P)** note this proposal would decouple Missouri from the federal research and development (R&D) deduction. B&P notes that prior to January 1, 2022, businesses were allowed to fully deduct expenses in the first year they were incurred. However, since January 1, 2022, businesses have been required to amortize those costs over five years (fifteen years for foreign research). B&P further notes that Missouri has rolling conformity with the federal R&D deduction. When a business claims this deduction on their federal return, they also receive the tax benefit on their state return.

Section 143.121.3(14) would allow businesses with Missouri income tax to deduct the full amount of R&D expenses in the first year incurred. Section 143.121.2(7) requires taxpayers to add any amount of R&D expenses deducted from the Federal adjusted gross income (FAGI). Taxpayers are required to add that amount to the Missouri adjusted gross income (MAGI) to prevent taxpayers from receiving the same deduction twice. Section 143.121.2(7) also requires taxpayer to reduce their R&D deduction by the amount of any R&D tax credit received. This is consistent with current law and again prevents taxpayers from receiving a tax benefit for the same expenses twice.

B&P was unable to find enough reliable data to estimate the potential revenue impact from this provision. However, the potential loss to GR could be significant.

Given the number of returns which might be affected, **Oversight** will show DOR's abovementioned 1 FTE for purposes of this fiscal note. If multiple bills pass which require additional staffing and duties at substantial costs, DOR could request funding through the appropriation process.

Oversight notes officials from the Department of Revenue assume this proposal will have a negative fiscal impact on state revenue. Oversight does not have any information to the contrary. Therefore, Oversight will show DOR's estimated impact on the fiscal note.

FISCAL IMPACT – State Government	FY 2025 (10 Mo.)	FY 2026	FY 2027
GENERAL REVENUE			
Costs - §143.121			
Personnel Service	($29,900)	($36,598)	($37,330)
Fringe Benefits	($23,896)	($28,937)	($29,204)
Expense & Equipment	($22,234)	($570)	($582)
Total Costs -	($76,030)	($66,105)	($67,116)
FTE Change	1 FTE	1 FTE	1 FTE
Revenue Reduction - §143.121 - Addition and subtraction of income for research and experimentation costs	(Unknown, could be substantial)	(Unknown, could be substantial)	(Unknown, could be substantial)
ESTIMATED NET EFFECT ON GENERAL REVENUE	**(Unknown, could be substantial)**	**(Unknown, could be substantial)**	**(Unknown, could be substantial)**
Estimated Net FTE Change on General Revenue	1 FTE	1 FTE	1 FTE

FISCAL IMPACT – Local Government	FY 2025 (10 Mo.)	FY 2026	FY 2027
	$0	**$0**	**$0**

FISCAL IMPACT – Small Business

Certain small businesses that qualify for the proposed addition/subtraction could be impacted by this proposal.

FISCAL DESCRIPTION

Federal law requires taxpayers to amortize the deduction for research and experimental expenses over a period of years. This act allows a taxpayer to deduct the full amount of such expenses for the taxpayer's state income taxes during the tax year in which they were incurred.

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

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