COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

<u>L.R. No.</u>: 4524-02
<u>Bill No.</u>: SCS for HB 1619
<u>Subject</u>: Corporations; Revenue Department; Taxation and Revenue
<u>Type</u>: Original
<u>Date</u>: May 5, 2006

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2007	FY 2008	FY 2009
General Revenue	(Greater than $1,452,546)	(Greater than $3,137,526)	(Greater than $6,275,052)
Total Estimated Net Effect on General Revenue Fund	**(Greater than $1,452,546)**	**(Greater than $3,137,526)**	**(Greater than $6,275,052)**

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2007	FY 2008	FY 2009
Total Estimated Net Effect on <u>Other</u> State Funds	**$0**	**$0**	**$0**

Numbers within parentheses: ( ) indicate costs or losses.
This fiscal note contains 6 pages.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2007	FY 2008	FY 2009
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2007	FY 2008	FY 2009
Local Government	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

In response to an earlier version of this proposal, officials from the **Department of Revenue (DOR)** stated this legislation changes the filing requirements for franchise tax by repealing the current language in subsection 1 and replacing it with new threshold amounts beginning tax year 2007 and phasing out by 2010.

DOR assumes forms and programming changes will be required. DOR states they will not see a reduction in FTE for several years after the final phase out tax year, due to amended returns, correspondence, and phone calls.

DOR estimates their tax collections for the past four years for the corporate franchise tax and the corporate income tax have been;

	Corporate Franchise	Corporate Income	Total
2005	$120,000,000	$354,000,000	$474,000,000
2004	$91,300,000	$329,500,000	$420,800,000
2003	$70,200,000	$366,800,000	$437,000,000
2002	$20,700,000	$442,500,000	$463,200,000

ASSUMPTION (continued)

In response to an earlier version of this proposal, officials from the **Office of Administration - Budget and Planning (BAP)** stated this proposal eliminates the corporate franchise tax in graduated increments by FY 2012. BAP notes that $116.7 million was collected in corporate franchise tax in FY '05, therefore, general and total state revenues would be reduced by this amount by FY '12. BAP does not have the necessary detail to estimate the specific incremental impacts in immediate fiscal years, and therefore defers to the DOR for these estimates.

In response to an earlier version of this proposal, officials from the **University of Missouri - Economic and Policy Analysis Research Center** stated the following table presents the total tax due for corporations with all assets in Missouri and those with assets in Missouri and elsewhere. In this way, one can see the change in the distribution of the tax. Note that the tax would not go into effect until 2007. Hence, tax year 2006 serves as the baseline for measuring the change in franchise tax paid into net general revenues. We compute the effect would be small in 2007, with net general revenues declining from $288.6 million to $287.2 million. In other words, net general revenue would decline by $1.4 million in the first year the tax proposal of this bill implemented.

	Total Tax Due			
	Franchises with All assets in Missouri	Franchises with Assets both in Missouri and elsewhere	Total	Difference from previous year
2006	$93,166,992	$195,370,199	$288,537,191	
2007	$92,174,685	$195,013,907	$287,188,592	($1,348,599)
2008	$91,015,211	$194,273,721	$285,288,932	($1,899,660)
2009	$54,395,162	$116,376,679	$170,771,841	($114,517,091)
2010	$33,884,524	$72,607,689	$106,492,213	($64,279,628)

Over time, taxes collected from corporate franchise tax would decline to $285.3 million in 2008, $170.8 million in 2009 and $106.5 million in 2010.

In response to an earlier version of this proposal, according to the **Office of Administration - Division of Accounting**, collections for corporate franchise taxes in FY 2005 were $119.4 million.

Oversight has obtained additional information from the University of Missouri - Economic & Policy Analysis Research Center (MU-EPARC) that will assist us in calculating a more accurate annual reduction in corporate franchise tax revenue. MU-EPARC provided the number of returns that were filed in calendar year 2005 for the franchise tax by asset range. Therefore, Oversight ASSUMPTION (continued)

was able to estimate the franchise tax revenue received by DOR in calendar year 2005 by companies within various ranges of asset classes, such as;

Number of Returns	Range of Assets	Top End of Asset Range	Tax Rate	Estimated Franchise Taxes Generated
2,181	1 mil. to 2 mil.	$2,000,000	$0.000333	$1,452,546
980	2 mil. to 3 mil.	$3,000,000	$0.000333	$979,020
530	3 mil. to 4 mil.	$4,000,000	$0.000333	$705,960
TOTAL				$3,137,526

The first step of the phase-out occurs in calendar year 2007, with the threshold of assets raised from $1 million to $2 million (and the rate remaining at one-thirtieth of one percent). According to information provided by MU-EPARC, this will result in franchise tax revenue not being collected for 2,181 companies. Using the top end of the range of assets, this would result in reduction of $1,452,546 of revenue in FY 2008.

The second step of the phase-out occurs in calendar year 2008, with the threshold of assets raised from $2 million to $4 million (and again the rate remaining at one-thirtieth of one percent). This would result in an additional 1,510 (980 + 530) companies not required to pay franchise taxes. Again, using the top end of the range of assets, this would result in a reduction of an additional $1,684,980 ($979,020 + $705,960) of franchise tax revenue, for a total reduction for FY 2009 of $3,137,526.

For tax years 2009, 2010 and 2011, the thresholds continue to increase, and the rates now also begins to decrease. However, the fiscal impact for these years are beyond the scope of the fiscal note. Using DOR's estimate of $120 million in franchise fee taxes collected in calendar year 2005, this would mean the reduction in revenue from this proposal in fiscal years 2010 through 2012 would increase greatly, from $3,137,526 in FY 2009 to $120,000,000 in FY 2012 and beyond.

Since the phase-out of the corporate franchise tax starts with tax years beginning on or after January 1, 2007, **Oversight** will assume a reduction in General Revenue collections starting in FY 2007.

Oversight also assumes any saving to be realized by the Department of Revenue for not processing corporate franchise tax returns is beyond the scope of this fiscal note.

ASSUMPTION (continued)

Oversight was unable to obtain any responses on the phase-in of the bank tax credit. Therefore, Oversight assumes an unknown loss to the General Revenue Fund.

FISCAL IMPACT - State Government	FY 2007 (10 Mo.)	FY 2008	FY 2009
GENERAL REVENUE			
Loss - Department of Revenue Phase-out of the corporate franchise tax	($1,452,546)	($3,137,526)	($6,275,052)
Loss - General Revenue Phase-in of bank credit	(Unknown)	(Unknown)	(Unknown)
ESTIMATED NET EFFECT TO THE GENERAL REVENUE FUND	**(Greater than $1,452,546)**	**(Greater than $3,137,526)**	**(Greater than $6,275,052)**

FISCAL IMPACT - Local Government	FY 2007 (10 Mo.)	FY 2008	FY 2009
	$0	**$0**	**$0**

FISCAL IMPACT - Small Business

Small businesses that pay corporate franchise taxes would be positively fiscally impacted as a result of this proposal.

DESCRIPTION

This proposal changes the annual franchise tax rates and income threshold amounts for corporations beginning with tax year 2007.

By tax year 2011, the tax rate will be zero.

The proposal would implement a phase-in of a new bank tax credit.

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
University of Missouri
Economic and Policy Analysis Research Center

Mickey Wilson

Mickey Wilson, CPA
Director
May 5, 2006