

COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 0761-11
Bill No.: SS #2 for SCS for HCS for HB 444, 217, 225, 239, 243, 297, 402 & 172
Subject: Taxation and Revenue - Income
Type: Original
Date: May 7, 2007

Bill Summary: Would exempt certain retirement benefits from income taxation.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2008	FY 2009	FY 2010
General Revenue	(More than \$27,394,889 to More than \$18,594,889)	(More than \$48,915,837 to More than \$40,115,837)	(More than \$71,528,311 to More than \$62,728,311)
Total Estimated Net Effect on General Revenue Fund	(More than \$27,394,889 to More than \$18,594,889)	(More than \$48,915,837 to More than \$40,115,837)	(More than \$71,528,311 to More than \$62,728,311)

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2008	FY 2009	FY 2010
Total Estimated Net Effect on <u>Other</u> State Funds	\$0	\$0	\$0

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

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2008	FY 2009	FY 2010
Total Estimated Net Effect on <u>All</u> Federal Funds	\$0	\$0	\$0

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2008	FY 2009	FY 2010
General Revenue	11.0	11.0	11.0
Total Estimated Net Effect on FTE	11.0	11.0	11.0

☒ Estimated Total Net Effect on All funds expected to exceed \$100,000 savings or (cost).

☐ Estimated Net Effect on General Revenue Fund expected to exceed \$100,000 (cost).

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2008	FY 2009	FY 2010
Local Government	\$0	\$0	\$0

FISCAL ANALYSIS

ASSUMPTION

Officials from the **Office of the Secretary of State (SOS)** provided the following response:

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 SOS for Administrative Rules is less than \$2,500. The SOS recognizes that this is a small amount and does not expect that additional funding would be required to meet these costs. However, we also recognize 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 our office can sustain with our core budget. Therefore, we reserve 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.

Officials from the **Department of Revenue (DOR)** assume this proposal would make the following changes to Missouri income tax provisions:

Section 143.121 would require nonresidents to add back property taxes paid to another state which were deducted from taxable income on the federal return, beginning January 1, 2007. This section would also allow a deduction for qualified health care insurance premiums.

Section 143.124 would change the current pension deductions by removing the government and private pension deductions for all individuals, effective for tax years prior to December 31, 2006, and would allow taxpayers age 62 years of age and older to take a deduction for defined pensions, beginning January 1, 2007.

The amount of the deduction would be \$6,000 or 20%, to the extent the government pension is included in Federal Adjusted Gross Income (FAGI), capped at the amount of the maximum Social Security benefit. The deduction would phase in over six years.

Section 143.125 would allow a resident taxpayer (defined as any resident individual) to subtract social security benefits from their Missouri Adjusted Gross Income (MAGI), beginning January 1, 2007.

Section 143.1008 would create a tax refund check-off program for the After School Retreat and Assessment Grant Program Fund.

Administrative Impact:

Section 143.121 Taxation would need to add a line to the MO-A. Personal Tax would require 2 Temporary Tax Employee for key-entry, 1 Tax Processing Tech I for every 19,000 returns to be verified, and 1 Tax Processing Tech I for every 2,400 pieces of correspondence. Personal Tax would also require 2 Temporary Tax Employees for key-entry of 1040P and PTC forms, and 1 Tax Processing Tech I for every additional 5,000 returns to be verified and correspondence received, on the 1040P/PTC forms.

Customer Service would require 1 Tax Collection Technician I for every 15,000 calls a year on the income tax hot line due to lack of documentation, 1 Tax Collection Technician I for every 24,000 calls a year to the delinquency/collections lined on billings and denied deductions due to lack of documentation, and 1 Tax Processing Technician I for every additional 4,800 contacts in the field offices. DOR anticipates most customers would contact the department via phone, therefore, would only request 1 FTE for each of the larger field offices including Kansas City, St. Louis, and Springfield.

Information Technology (ITSD/DOR) assumes the IT portion of this request could be accomplished within existing resources, however; if priorities shift, additional FTE/overtime would be needed to implement this proposal. ITSD/DOR estimates that this legislation could be implemented utilizing 8 existing CIT III for 4 months at a cost of \$133,952.

In summary, DOR submitted a cost estimate for eleven FTE additional staff, and related equipment and expense with a total of \$487,209 for FY 2008, \$527,852 for FY 2009, and \$543,687 for FY 2010.

Oversight has, for fiscal note purposes only, changed the starting salary for the additional staff to correspond to the second step above minimum for comparable positions in the state's merit system pay grid. This decision reflects a study of actual starting salaries for new state employees for a six month period and the policy of the Oversight Subcommittee of the Joint Committee on Legislative Research. In addition, Oversight has reduced certain equipment and expense items in accordance with Office of Administration budget guidelines. Oversight assumes that the relatively small number of additional staff can be located in existing office space, and will further assume that DOR would be able to implement the proposal with existing IT staff. If multiple provisions are enacted requiring additional staffing or if unanticipated costs are incurred, DOR could request resources through the budget process.

ASSUMPTION (continued)

Officials from the **University of Missouri, Economic and Policy Analysis Research Center** (EPARC) prepared an analysis for this proposal which indicated a fully implemented revenue reduction of \$127.5 Million for this proposal. EPARC officials told us their analysis was based on taxpayers aged 65 and older, and that information on taxpayers between the ages of sixty-two and sixty-five was not available.

Oversight will utilize the EPARC estimate for the initial reduction in annual tax collections. Oversight has analyzed cost of living increases for social security benefits; over the past five years benefits have increased an average 2.72 percent. Oversight will assume a 2.72% annual increase in lost revenues due to anticipated cost of living increases for the retirement benefits eligible for deduction in this proposal. Because of the presumed impact of taxpayers between the ages of sixty-two and sixty-five, Oversight will indicate a revenue reduction greater than the amounts calculated.

	Calendar Year	Fiscal Year	Revenue Reduction
20 percent deduction	2007	2008	\$26.9 million
35 percent deduction	2008	2009	\$48.4 million
50 percent deduction	2009	2010	\$71.0 million

Oversight is not able to estimate the potential for revenue reductions as a result of additional taxpayers filing returns who would not have filed a tax return under existing conditions, and Oversight is not able to determine the potential for revenue reductions due to the impact of this proposal on the existing Circuit Breaker and Homestead Exemption provisions.

Officials from the **Office of Administration, Division of Budget and Planning** (BAP) stated that a previous version of the proposal would have no fiscal impact to their organization, and deferred to EPARC or DOR for an estimate of the revenue loss.

ASSUMPTION (continued)

Deduction for Health Insurance Premiums

None of the organizations responding to our request for fiscal information provided an estimate of the fiscal impact of this provision.

In response to a similar proposal in the previous session (HB 1677 LR 4612-01, 2006) officials from the **Office of Administration, Division of Budget and Planning** (BAP) provided the following demographic information:

According to the US Bureau of Labor Statistics 2004 Consumer Expenditure Survey, the average consumer unit spent \$1,332 on health insurance. The average consumer unit had 2.5 people, implying an estimated \$533 per person for health insurance. The latest US Census Bureau estimate for Missouri was 5.8 million people, therefore an estimated \$3.1 billion was spent on health insurance in Missouri in 2004. Assuming a 4.5% marginal tax rate, the proposal would lower general and total state revenues by \$140 million (\$3.1 billion x 4.5% marginal tax rate) annually when fully implemented.

BAP noted that this deduction would only apply to health insurance premiums included in Federal Adjusted Gross Income (FAGI). It is likely that a significant amount of health insurance premiums are excluded from FAGI if the taxpayers participate in "cafeteria" plans. Further, taxpayers that itemize their deductions may already deduct these payments. Therefore, the figures above may overstate the actual impact by an unknown amount.

Oversight has collected information regarding an existing program in the State of Utah which is similar to this proposal. Oversight will utilize information regarding Utah's program to estimate the fiscal impact of this bill to Missouri.

Oversight was not able to determine the number of health care premium amounts that were taken as a deduction on taxpayers's federal return or the percentage of health insurance premiums that were paid through a cafeteria plan (pre-tax). Oversight was also not able to determine the comparability of the demographics of the state of Utah and the state of Missouri. However, Oversight will assume a similar number of Missouri residents will qualify for and take the deduction allowed in this proposal.

ASSUMPTION (continued)

Utilizing the number of returns filed in Utah in 2004 (990,317) compared to Missouri (2,241,250), Oversight calculated a range of fiscal impact for a similar same program in Missouri from \$9.2 million to \$22.2 million per year. Officials from the Office of Administration, Division of Personnel advised us that 56.9% of state employees pay their health insurance premiums using the cafeteria plan. Assuming the statewide cafeteria plan participation rate would range from 25% to 50% would mean that the fiscal impact of this proposal would range from \$2.3 million \$11.1 million per year.

Nonresident Property Tax Modification

None of the organizations responding to our request for fiscal information provided an estimate of the fiscal impact of this provision, however, in response to a similar proposal in a previous session (SB 888, LR 2651-01, 2004) officials from the **Office of Administration, Division of Budget and Planning** (BAP) assumed the proposal would disallow the deduction for property taxes paid to another state on nonresident tax returns. Based on data from the IRS Statistics of Income and the Department of Revenue, BAP made the following assumptions:

- In Missouri in 2001, those with itemized deductions who claim a real estate (property) tax deduction have an average deduction of \$1,677 and 91% of those with itemized deductions claim a real estate tax deduction.
- In 2001, there were 120,000 nonresident returns that claimed itemized deductions.
- Assuming that 91% of these returns claim a real estate (property) tax deduction, there would be 109,200 nonresident returns claiming a \$1,677 deduction for real estate (property) tax paid to another state.

Based on these assumptions, Missouri would gain about \$183 million in taxable income by disallowing this deduction. Assuming that this would be taxed at the 6% tax rate, the revenue gain would be about \$11 million. BAP assumed that property taxes subject to disallowance would be greater in 2004 than in 2001 but could not locate more recent information.

Oversight was unable to locate more recent information regarding this provision, and will use the previous BAP estimate. Oversight will indicate a positive impact greater than \$11 million per year.

ASSUMPTION (continued)

Tax Refund Check-off Program

Oversight assumes this proposal would have no fiscal impact on the state or local governments.

This proposal would reduce Total State Revenue.

<u>FISCAL IMPACT - State Government</u>	FY 2008 (10 Mo.)	FY 2009	FY 2010
GENERAL REVENUE			
<u>Costs - Department of Revenue</u>			
Personal Service (11.0 FTE)	(\$196,020)	(\$242,281)	(\$249,549)
Fringe Benefits	(\$86,366)	(\$106,749)	(\$109,951)
Tax Season Temporaries	(\$49,440)	(\$61,108)	(\$62,941)
Expense and Equipment	<u>(\$63,063)</u>	<u>(\$5,699)</u>	<u>(\$5,870)</u>
Total Costs - DOR	<u>(\$394,889)</u>	<u>(\$415,837)</u>	<u>(\$428,311)</u>
<u>Revenue reduction - Department of Revenue</u>			
Deduction for retirement benefits	<u>(More than \$26,900,000)</u>	<u>(More than \$48,400,000)</u>	<u>(More than \$71,000,000)</u>
Deduction for health insurance premiums	<u>(\$2,300,000 to \$11,100,000)</u>	<u>(\$2,300,000 to \$11,100,000)</u>	<u>(\$2,300,000 to \$11,100,000)</u>
<u>Revenue - Department of Revenue</u>			
Increase in Missouri income tax from disallowance of out-of-state property tax on nonresident returns	<u>More than \$11,000,000</u>	<u>More than \$11,000,000</u>	<u>More than \$11,000,000</u>
ESTIMATED NET EFFECT TO THE GENERAL REVENUE FUND	<u>(More than \$27,394,889 to More than \$18,594,889)</u>	<u>(More than \$48,915,837 to More than \$40,115,837)</u>	<u>(More than \$71,528,311 to More than \$62,728,311)</u>
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Estimated Net FTE Change for General Revenue Fund	<u>11.0 FTE</u>	<u>11.0 FTE</u>	<u>11.0 FTE</u>

<u>FISCAL IMPACT - Local Government</u>	<u>FY 2008</u> <u>(10 Mo.)</u>	<u>FY 2009</u>	<u>FY 2010</u>
	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>

FISCAL IMPACT - Small Business

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

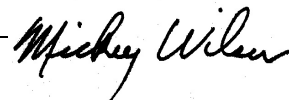
FISCAL DESCRIPTION

The proposal would exempt certain retirement benefits from state income tax.

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 the Secretary of State
Office of Administration
Division of Budget and Planning
Department of Revenue
University of Missouri
Economic Policy and Research Center



Mickey Wilson, CPA
Director
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