

COMMITTEE ON LEGISLATIVE RESEARCH  
OVERSIGHT DIVISION

**FISCAL NOTE**

L.R. No.: 1033-01  
Bill No.: HB 333  
Subject: Taxation and Revenue - General; Taxation and Revenue - Income; Banks and Financial Institutions  
Type: Original  
Date: January 10, 2019

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Bill Summary: This proposal allows interest on deposits held at a Federal Reserve bank to be subtracted from a taxpayer's adjusted gross income.

**FISCAL SUMMARY**

<b>ESTIMATED NET EFFECT ON GENERAL REVENUE FUND</b>			
FUND AFFECTED	FY 2020	FY 2021	FY 2022
General Revenue	(\$54,285 to \$117,143)	(\$34,286 to \$74,286)	(\$34,286 to \$74,286)
<b>Total Estimated Net Effect on General Revenue</b>	<b>(\$54,285 to \$117,143)</b>	<b>(\$34,286 to \$74,286)</b>	<b>(\$34,286 to \$74,286)</b>

<b>ESTIMATED NET EFFECT ON OTHER STATE FUNDS</b>			
FUND AFFECTED	FY 2020	FY 2021	FY 2022
<b>Total Estimated Net Effect on <u>Other</u> State Funds</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>

Numbers within parentheses: ( ) indicate costs or losses.  
This fiscal note contains 7 pages.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2020	FY 2021	FY 2022
<b>Total Estimated Net Effect on <u>All</u> Federal Funds</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2020	FY 2021	FY 2022
<b>Total Estimated Net Effect on FTE</b>	<b>0</b>	<b>0</b>	<b>0</b>

☒ 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 2020	FY 2021	FY 2022
<b>Local Government</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>

## **FISCAL ANALYSIS**

### **ASSUMPTION**

Officials at the **Office of Administration Division of Budget and Planning (B&P)** assume this proposal would exempt interest received from deposits at a federal reserve bank from individual and corporate income tax. B&P notes that due to the ambiguous language currently in law, some taxpayers may already be claiming this exemption. For the purpose of this fiscal note, B&P assumes that all entities eligible to claim the proposed income exemption are corporate depository institutions (i.e. banks).

In 2017, the St. Louis Federal Reserve paid interest of \$3 million total to all depository institutions within its region. There are seven states that make up the St. Louis Federal Reserve region. For the purpose of this fiscal note, B&P assumes that the \$3 million in interest payments were paid evenly among all regional states. However, B&P acknowledges that some states may have larger or smaller banks than those in Missouri, resulting in more or less actual interest payments to Missouri banks than estimated here. Therefore, B&P estimates that this proposal could exempt up to \$429,000 ( $\$3,000,000 / 7$ ) in interest payments from the corporate income tax.

In 2017, the Kansas City Federal Reserve paid interest of \$10 million total to all depository institutions within its region. There are seven states that make up the Kansas City Federal Reserve region. For the purpose of this fiscal note, B&P assumes that the \$10 million in interest payments were paid evenly among all regional states. However, B&P acknowledges that some states may have larger or smaller banks than those in Missouri, resulting in more or less actual interest payments to Missouri banks than estimated here. Therefore, B&P estimates that this proposal could exempt up to \$1,429,000 ( $\$10,000,000 / 7$ ) in interest payments from the corporate income tax.

B&P notes that while the current corporate tax rate is 6.25%, this tax rate is scheduled to decline to 4.0% beginning January 1, 2020. Therefore, B&P will adjust estimates for FY 2021 and beyond to reflect the lower corporate tax rate. B&P estimates that this proposal could reduce Total State Revenue and General Revenue by less than \$116,000 ( $6.25\% * (\$429,000 + \$1,429,000)$ ) in FY 2020. Beginning in FY 2021, and annually thereafter, this proposal could reduce Total State Revenue and General Revenue by less than \$74,000 ( $4.0\% * (\$429,000 + \$1,429,000)$ ).

This proposal will impact the calculation under Article X, Section 18(e).

ASSUMPTION (continued)

Officials at the **Department of Revenue (DOR)** assume this proposal outlines what is to be subtracted from a taxpayer's federal adjusted gross income. The proposed legislation includes interest received on deposits held at a federal reserve bank as an eligible subtraction.

There are two Federal Reserve Banks located in Missouri, the Federal Reserve Bank of St. Louis, and the Federal Reserve Bank of Kansas City.

The St. Louis Federal Reserve includes the state of Arkansas and portions of Illinois, Indiana, Kentucky, Mississippi, the eastern half of Missouri and West Tennessee. It has branches in Little Rock, Louisville, and Memphis. According to the 2017 Independents Auditor's Report, the St. Louis Federal Reserve Bank paid \$3 million dollars in interest to the regional depository institutions.

Seven states make reserve deposits into the St. Louis Federal Reserve Bank. The St. Louis Federal Reserve Bank is paying an estimated total of \$428,571 in interest to Missouri depository institutions (\$3,000,000/7). Multiply that amount by Missouri's current corporate tax rate (6.25%) and that would generate roughly \$26,786 in annual revenues. If the interest earned on reserves deposits is exempt under chapter 143, Missouri could see a decrease in annual revenues in an amount up to \$26,786 in fiscal year 2020. The corporate income tax rate will be reduced to 4% for all tax years beginning on or after January 1, 2020. In fiscal years after FY 2020, if the interest earned on reserves deposits is exempt under chapter 143, Missouri could see a decrease in annual revenues in an amount up to \$17,143.

The Federal Reserve Bank of Kansas City includes Colorado, Kansas, Nebraska, Oklahoma, Wyoming and portions of Missouri and New Mexico. According to the 2017 Independents Auditor's Report, the Federal Reserve Bank of Kansas City paid \$10 million dollars in interest to the regional depository institutions.

Seven states make reserve deposits into the Federal Reserve Bank of Kansas City. The Federal Reserve Bank of Kansas City is paying an estimated total of \$1,428,571 in interest to Missouri depository institutions (\$10,000,000/7). Multiply that amount by Missouri's current corporate tax rate (6.25%) and that would generate roughly \$89,286 in annual revenues. If the interest earned on reserves deposits is exempt under chapter 143, Missouri could see a decrease in annual revenues in an amount up to \$89,286 in fiscal year 2020. The corporate income tax rate will be reduced to 4% for all tax years beginning on or after January 1, 2020. In fiscal years after FY 2020, if the interest earned on reserves deposits is exempt under chapter 143, Missouri could see a decrease in annual revenues in an amount up to \$57,142.

ASSUMPTION (continued)

This is a high estimate since this is assuming all corporations are currently including interest earned on reserve deposits as income on their corporate return. Line 1a on the MO-1120 Corporate Income Tax Return allows for a subtraction of interest from exempt federal obligation. A schedule, which is prepared by the company, is required. Due to the unregulated and discretionary nature of the schedules, the Department is unable to determine if interest earned on reserve deposits is included within line 1a. The Department assumes that some banks schedule the Federal Reserve deposit interest as exempt from corporate income tax and some report the interest as part of their taxable income.

Impact to General Revenue		
FY20	FY21	FY22
(\$116,072)	(\$74,285)	(\$74,285)

**Oversight** verified the data supplied by B&P and DOR as to the amount of interest paid. However, Oversight notes there was a large difference in the amount paid in interest each fiscal year partially based on the changing interest rate set by the Federal Reserve Bank. In St. Louis the interest paid in FY 2017 was \$3 million but it was only \$2 million in FY 2016. In Kansas City the interest paid in FY 2017 was \$10 million when it was only \$4 million in FY 2016. Due to the Federal Reserve Bank changing interest rates and deposit amounts there could continue to be a significant difference yearly in interest paid and therefore, Oversight will show a range in the fiscal note.

**Oversight** was also unable to verify the split of the interest among the various states. Oversight will use the methodology used by B&P and DOR of dividing the interest equally among the states. Oversight notes the corporate rate is 6.25% for FY 2020 and decreases to 4% for FY 2021 and beyond. Oversight calculated the interest as follows:

FY 2020

St. Louis  $\$2,000,000/7 \times 6.5\% = \$18,571$   
St. Louis,  $\$3,000,000/7 \times 6.5\% = \$27,857$

FY 2021

St. Louis  $\$2,000,000/7 \times 4\% = \$11,429$   
St. Louis  $\$3,000,000/7 \times 4\% = \$17,143$

ASSUMPTION (continued)

FY 2020

Kansas City \$4,000,000/7 x 6.25% = \$35,714

Kansas City \$10,000,000/7 x 6.25% = \$89,286

FY 2021

Kansas City \$4,000,000/7 x 4% = \$22,857

Kansas City \$10,000,000/7 x 4% = \$57,143

**Oversight** will show the impact in FY 2020 as \$54,285 (\$18,571 + \$35,714) to \$117,143 (\$27,857 + \$89,286) and will show in FY 2021 and beyond as \$34,286 (\$11,429 + \$22,857) to \$74,286 (\$17,143 + \$57,143).

<u>FISCAL IMPACT - State Government</u>	FY 2020 (10 Mo.)	FY 2021	FY 2022
<b>GENERAL REVENUE</b>			
<u>Revenue Reduction</u> - DOR - §143.121 - subtraction of interest on deposits held at the Federal Reserve from Adjusted Gross Income	(\$54,285 to <u>\$117,143</u> )	(\$34,286 to <u>\$74,286</u> )	(\$34,286 to <u>\$74,286</u> )
<b>ESTIMATED NET EFFECT ON GENERAL REVENUE</b>	<b><u>(\$54,285 to \$117,143)</u></b>	<b><u>(\$34,286 to \$74,286)</u></b>	<b><u>(\$34,286 to \$74,286)</u></b>
<u>FISCAL IMPACT - Local Government</u>	FY 2020 (10 Mo.)	FY 2021	FY 2022
	<u><b>\$0</b></u>	<u><b>\$0</b></u>	<u><b>\$0</b></u>

FISCAL IMPACT - Small Business

This may impact small banks, if they are not already claiming the exemption granted in this proposal.

### FISCAL DESCRIPTION

This bill subtracts interest received on deposits held at a Federal Reserve Bank from a taxpayer's Missouri 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 Administration  
Division of Budget and Planning



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January 10, 2019