COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 1033-02
Bill No.: HCS for HB 333
Subject: Taxation and Revenue - General; Taxation and Revenue - Income; Banks and Financial Institutions
Type: Original
Date: February 18, 2019

Bill Summary: This proposal modifies provisions relating to taxation.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2020	FY 2021	FY 2022
General Revenue	($54,285 to $117,143)	$2,625,714 to $4,265,714	$2,625,714 to $4,265,714
Total Estimated Net Effect on General Revenue	**($54,285 to $117,143)**	**$2,625,714 to $4,265,714**	**$2,625,714 to $4,265,714**

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2020	FY 2021	FY 2022
Total Estimated Net Effect on Other 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 2020	FY 2021	FY 2022
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

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

☒ 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
Local Government	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

§143.121 Federal Reserve Interest
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 depositary 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 depositary 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 x 6.5% = $18,571
St. Louis, $3,000,000/7 x 6.5% = $27,857

FY 2021
St. Louis $2,000,000/7 x 4% = $11,429
St. Louis $3,000,000/7 x 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).

§148.064 Bank Franchise Tax
Officials at the **Department of Revenue** (**DOR**) assume this proposal places an end date on the credit authorized in §148.064.6 for all tax years beginning on or after January 1, 2020.

The Bank Franchise Tax (BFT) credit in §148.064.6 gives financial institutions a credit to reflect the previous reduction in the franchise tax rate. For tax years beginning on or after January 1, 2016, no annual franchise tax is imposed under §147.010. Section 148.064.7 creates a new credit once the franchise tax is repealed, but the current statute does not expressly repeal the credit authorized in §148.064.6. This creates a double credit which is not necessary and reduces state revenue.

The Department took the average amount of credits redeemed in the last three fiscal years to come up with the fiscal impact. The chart below reflects the total dollar amount of the bank franchise tax credits that have been issued in each fiscal year since the repeal of the corporate franchise tax.

	FY 2016	FY 2017	FY 2018	Average
BFT credit redeemed	$3,098,901	$2,701,672	$4,372,771	$3,391,115

Impact to Total State Revenue		
FY 2020	FY 2021	FY 2022
$1,695,558	$3,391,115	$3,391,115

Oversight confirmed with DOR that the BFT credits redeemed listed above are only the portion claimed under §148.064.6.

ASSUMPTION (continued)

Officials at the **Office of Administration Division of Budget and Planning** (**B&P**) assume this proposal would disallow the bank franchise tax credit under §148.064.6 beginning with tax year 2020. B&P notes that this proposal does not change the alternative bank tax credit allowed under Section 148.064.7.

B&P further notes that the bank franchise tax was fully phased-out by tax year 2016. However, the language in Section 148.064.6 does not rely on the calculation utilized to determine a franchise tax liability, which would have made any credit equal to zero once the franchise tax rate became zero. Rather, it is a simple asset calculation, which allows banks to claim a positive credit even without a franchise tax being levied.

The following table shows the bank franchise tax credit redemptions for the previous three fiscal years.

Fiscal Year	Redemptions under Section 148.064.6
2016	$3,227,364
2017	$2,756,090
2018	$4,347,236
3-year average	$3,443,563

Therefore, B&P estimates that this proposal will increase Total State Revenue and General Revenue by $3.4 million annually, beginning in FY 2021.

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

Officials at the **Department of Insurance, Financial Institutions and Professional Registration** assume there is no fiscal impact from this proposal.

Oversight notes the changes in this proposal would be effective beginning January 1, 2020, and the first income tax returns would be filed reflecting these changes in January, 2021 (FY 2021). For fiscal note purposes, Oversight includes the revenue reductions in the year in which the affected tax returns would be filed; therefore, the first year this proposal would have an impact would be FY 2021.

Based on data provided on DOR's website, Oversight was able to confirm the bank franchise redemption data presented by B&P. Due to the significant difference in redemption data from

ASSUMPTION (continued)

year to year, Oversight assumes an increase of $2.7 million to $4.3 million to General Revenue annually from the elimination of the bank franchise tax credit.

FISCAL IMPACT - State Government	FY 2020 (10 Mo.)	FY 2021	FY 2022
GENERAL REVENUE			
Revenue Reduction - DOR - §143.121 - subtraction of interest on deposits held at the Federal Reserve from Adjusted Gross Income	($54,285 to $117,143)	($34,286 to $74,286)	($34,286 to $74,286)
Additional Revenue - DOR - §148.064.6 elimination of the bank franchise tax credit	$0	$2,700,000 to $4,300,000	$2,700,000 to $4,300,000
ESTIMATED NET EFFECT ON GENERAL REVENUE	**($54,285 to $117,143)**	**$2,625,714 to $4,226,714**	**$2,625,714 to $4,265,714**

FISCAL IMPACT - Local Government	FY 2020 (10 Mo.)	FY 2021	FY 2022
	$0	**$0**	**$0**

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.

Current law provides for a tax credit for banking institutions to compensate for franchise taxes paid by banking institutions, as well as a tax credit that may be claimed in the event the corporate franchise tax is repealed by the General Assembly. Because the corporate franchise tax was repealed beginning January 1, 2016, for all tax years beginning on or after January 1, 2020, this act disallows the tax credit designed to compensate for the franchise 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

Department of Insurance, Financial Institutions and Professional Registration
Department of Revenue
Office of Administration
  Division of Budget and Planning

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JH:LR:OD