COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 1398H.01I
Bill No.: HB 558
Subject: Taxation and Revenue - General; Taxation and Revenue - Income; Revenue, Department of; Teachers; Education, Elementary and Secondary; Retirement - Schools
Type: Original
Date: February 22, 2021

Bill Summary: This proposal would authorize an income tax deduction for certain public school retirement system participants.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2022	FY 2023	FY 2024
General Revenue Fund	$0	Could significantly exceed ($221,363,261)	Could significantly exceed ($221,339,504)
Total Estimated Net Effect on General Revenue	**$0**	**Could significantly exceed ($221,363,261)**	**Could significantly exceed ($221,339,504)**

*The Department of Revenue notes as written, the statute would allow all of an individual's income to be deducted, even income that was outside the income covered by the retirement system such as capital gains, business income or income from a second job. The amounts above are only the tax revenue received on income covered by the retirement system (both current employees contributing to the systems and retirees receiving benefits from the systems). Therefore, Oversight used "could significantly exceed".

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2022	FY 2023	FY 2024
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 2022	FY 2023	FY 2024
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2022	FY 2023	FY 2024
General Revenue - DOR	0 FTE	2 FTE	2 FTE
Total Estimated Net Effect on FTE	**0 FTE**	**2 FTE**	**2 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 2022	FY 2023	FY 2024
Local Government	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

Officials from the **Office of Administration – Budget & Planning Division (B&P)** state this proposed legislation could reduce Total State Revenue (TSR) by an amount that could be significantly greater than $212,899,159 once SB 509 (2014) has fully implemented.

B&P further states this proposed legislation, beginning with Tax Year 2022, would exempt all income for taxpayers who participate in a retirement system under sections 169.020, 169.280, 169.420, or 169.610, RSMo. B&P notes that both the Public School Retirement System (PSRS) and Public Education Employee Retirement System (PEERS) fall under the above sections.

B&P further notes that this proposed legislation only requires a taxpayer to participate in a qualifying retirement plan. This would include both individuals receiving a pension benefit from and individuals contributing to a qualifying retirement plan.

B&P also notes that because this proposed legislation would exempt **all** income for a qualifying individual, it may encourage individuals who file joint returns to attribute the majority of their combined income to the exempted spouse.

In addition, this proposed legislation would exempt **all** income from participating taxpayers. B&P notes that this includes, but is not limited to:

- Pension payments
- Social Security payments
- Other retirement income
- Salary income related to teaching/education
- Income from other sources (such as part-time employment)
- Capital Gains
- Businesses Income (if taxpayer or spouse owns their own business)
- Farm Income (if taxpayer or spouse operates a farm)
- Rental Income (if taxpayer or spouse owns rental property)

Based on data published PSRS and PEERS, during Fiscal Year 2020 there were 64,595 individuals receiving PSRS benefits and 78,848 individual contributing to the PSRS system. During Fiscal Year 2020, there were 33,232 individuals receiving PEERS benefits and 50,179 individuals contributing to the PEERS system.

During Fiscal Year 2020, the PSRS system paid $2,813,232,000 in benefits and the PEERS system paid $330,338,000 in benefits. B&P assumes that all benefits paid would become exempt from individual income taxes under this proposal. B&P notes that per Section 143.123, RSMo, the first $6,000 for public pensions are exempt from tax. B&P estimates that of the total benefits paid $586,962,000 ((64,595 PSRS beneficiaries + 33,232 PEERS beneficiaries) x $6,000 current exemption) would already be exempt under current law.

Therefore, B&P estimates that this proposed legislation would exempt $2,556,608,000 ($2,813,232,000 PSRS + $330,338,000 PEERS - $586,962,000 currently exempt) in pension benefits from income tax.

During Fiscal Year 2020, the required salary contribution for PSRS members was 14.5% of their covered income, while the required salary contribution for PEERS members was 6.86% of their covered income. In addition, member contributions to the PSRS system were $186,415,456 and member contribution to the PEERS system were $22,793,137. Therefore, B&P estimates that this proposed legislation would exempt $1,285,623,834 PSRS member salaries ($186,415,456 contributions / 14.5% required salary contribution) and $332,261,472 PEERS member salaries ($22,793,137 contributions / 6.86% required salary contributions).

In total, B&P estimates that this proposed legislation will exempt at least $4,174,493,306 in income from the Individual Income Tax. However, as noted above, this proposed legislation would exempt all income for a qualifying individual.

B&P notes that it does not have any information on other source income that could also become exempt under this proposed legislation. Therefore, the actual impact of this proposal could be significantly greater than the estimates included here.

Exemptions do not reduce revenues on a dollar for dollar basis, but rather in proportion to the top tax rate applied. Therefore, B&P will show the estimated impacts throughout the implementation of the tax rate reductions from SB 509 (2014).

	Tax Year / Fiscal Year			
Tax Rate	2022 (FY23)	2023 (FY24)	2024 (FY25)	2025 (FY26)
5.40%	Significantly Greater than ($225,422,639)	Significantly Greater than ($225,422,639)	Significantly Greater than ($225,422,639)	Significantly Greater than ($225,422,639)
5.30%	Significantly Greater than ($221,248,145)	Significantly Greater than ($221,248,145)	Significantly Greater than ($221,248,145)	Significantly Greater than ($221,248,145)
5.20%	-	Significantly Greater than ($217,073,652)	Significantly Greater than ($217,073,652)	Significantly Greater than ($217,073,652)
5.10%	-	-	Significantly Greater than ($212,899,159)	Significantly Greater than ($212,899,159)

Officials from the **Missouri Department of Revenue (DOR)** state this proposed legislation, starting January 1, 2022, would allow a deduction from Missouri adjusted gross income of one hundred percent (100%) of the income of any taxpayer who participates in the PSRS or PEERS retirement system. As written, the statute would allow all of an individual's income to be deducted, even income that was outside the income covered by the retirement system such as capital gains, business income or income from a second job.

Based on information from the PSRS/PEERS Statistical CAFR there are 64,595 PSRS retirees that receive benefits totaling $2,425,662,000 and there are 33,232 PEERS retirees that receive benefits totaling $130,946,000. For a total of $2,556,608,000 in retirement income eligible for this deduction. DOR notes there is currently allowed in Section 143.123, RSMo, a pension exemption up to $6,000 for qualifying taxpayers.

Additionally, PSRS/PEERS have active members with salary income that would be eligible for this proposed legislation:

PSRS Active Members	
Vested	61,016
Non-Vested	17,832
Required Salary Contribution	14.50%
PSRS Contributions	$186,415,456
Estimated Salary	**$1,285,623,834**

PEERS Active Members	
Vested	26,981
Non-Vested	23,198
Required Salary Contribution	6.86%
PSRS Contributions	$22,793,137
Estimated Salary	**$332,261,472**

This brings the total of the retirement and current salaries that would eligible for this deduction to $4,174,493,306. As previously mentioned, this proposed legislation allows all their income to be deducted. DOR was only able to calculate their salary and pension amounts. We do not have information on the number with second jobs, small businesses or other income sources that they could also deduct. Therefore, DOR notes the estimates provided will be higher than actual expected losses.

DOR notes a deduction is not a dollar for dollar loss but is a reduction based on the Individual Income Tax rate at the time. While this proposed legislation begins with Tax Year 2022, the returns claiming the deduction will not be filed until January 1, 2023 (Fiscal Year 2023).

	Tax Year / Deduction Allowance			
Tax Rate	2022 (FY23)	2023 (FY24)	2024 (FY25)	2025 (FY26)
5.40%	$225,422,639	$225,422,639	$225,422,639	$225,422,639
5.30%	$221,248,145	$221,248,145	$221,248,145	$221,248,145
5.20%		$217,073,652	$217,073,652	$217,073,652
5.10%			$212,899,159	$212,899,159

DOR anticipates the need for one (1) FTE Associate Customer Service Representative for every 14,700 errors created, one (1) FTE Associate Customer Service Representative for every 5,700 pieces of correspondence generated, and additional equipment and expense for forms and programming changes.

Due to the number of individuals that could potentially claim the exemption created under this proposed legislation, **Oversight** will include DOR's administrative costs being paid from GR. However, Oversight notes the exemption created would be for all tax years beginning on or after January 1, 2022. Tax Year 2022 tax returns would not be filed until after January 1, 2023 (Fiscal Year 2023). Therefore, Oversight assumes DOR can hire the FTE requested beginning July 1, 2022 (Fiscal Year 2023) and have six (6) months remaining to train such FTE before the first tax returns claiming the exemption created are filed.

Oversight notes the current Individual Income Tax rate is 5.4% (with three (3) additional rate reductions pending pursuant to SB 509 – 2014). As stated in the fiscal note for HB 555 (2021), B&P assumes, based on current revenue forecasts and average revenue growth, that revenues in Fiscal Year 2021, Fiscal Year 2024, and Fiscal Year 2025 will reach the SB 509 (2014) growth trigger requirement for reductions to the top rate of tax. Therefore, the top rate of tax will be reduced by 0.1% in Tax Year(s) 2022 (5.3%), 2025 (5.2%), and 2026 (5.1%) under SB 509 (2014).

Therefore, **Oversight** will report the impact(s) to the fiscal years reported in this fiscal note using a tax rate of 5.3%.

Oversight notes the tax exemption created is for all tax years beginning on or after January 1, 2022. Tax Year 2022 tax returns would not be filed until after January 1, 2023 (Fiscal Year 2023).

Therefore, for purposes of this fiscal note, Oversight will report a revenue reduction equal to an amount that "Could significantly exceed" (accounting for the income of qualifying individuals that cannot be determined (E.g. secondary occupations, farm income, business income)) the amount(s) estimated by B&P and DOR, beginning in Fiscal Year 2023.

Officials from the **Kansas City Public School Retirement System** do not anticipate this proposed legislation will cause a fiscal impact on their organization. Oversight does not have any information to the contrary. Therefore, Oversight will not report a fiscal impact for this organization.

FISCAL IMPACT – State Government	FY 2022 (10 Mo.)	FY 2023	FY 2024
GENERAL REVENUE FUND			
Revenue Reduction – Section 143.178 – Public School Retirement Deduction	$0	Could significantly exceed ($221,248,145)	Could significantly exceed ($221,248,145)
Cost – Section 143.178 – DOR			
Personnel Services	$0	($49,207)	($49,699)
Fringe Benefits	$0	($40,487)	($40,653)
Equipment & Expense	$0	($25,422)	($1,007)
Total Cost	$0	($115,116)	($91,359)
FTE	0	2	2
ESTIMATED NET EFFECT ON GENERAL REVENUE FUND	**$0**	**Could significantly exceed ($221,363,261)**	**Could significantly exceed ($221,339,504)**

FISCAL IMPACT – Local Government	FY 2022 (10 Mo.)	FY 2023	FY 2024
	$0	**$0**	**$0**

FISCAL IMPACT – Small Business

Small businesses that are owned by a taxpayer who participates in a retirement system established under chapter 169 may be positively impacted by this proposal.

FISCAL DESCRIPTION

Beginning on January 1, 2022, this bill provides that 100% of the income any taxpayer who participates in a retirement system established under Section 169.020, 169.280, 169.420, or 169.610, RSMo., to the extent that such income is included in the taxpayer's federal adjusted gross income, may be deducted from his or her Missouri adjusted gross income to determine his or her taxable income. If the individual files a combined return with a spouse, any income that would otherwise be attributable to the taxpayer if the taxpayer filed separately, to the extent that such income is included in the taxpayers' combined federal adjusted gross income, may be deducted from their Missouri combined 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

Office of Administration – Budget & Planning Division
Missouri Department of Revenue
Kansas City Public School Retirement System

Julie Morff
Director
February 22, 2021

Ross Strope
Assistant Director
February 22, 2021