

COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 2454H.03C
Bill No.: HCS for HB 1202
Subject: Economic Development; Revenue, Department of; Taxation and Revenue -
Income; Business and Commerce; Economic Development, Department of;
Contracts and Contractors; Administration, Office of
Type: Original
Date: March 18, 2021

Bill Summary: This proposal would change the laws regarding state contracts, taxation,
non-compete agreements, and the Department of Economic Development.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND				
FUND AFFECTED	FY 2022	FY 2023	FY 2024	Fully Implemented (FY 2027)
General Revenue Fund	(\$59,104,669)	(\$203,735,410)	(\$354,114,786)	(\$474,674,955)
Total Estimated Net Effect on General Revenue	(\$59,104,669)	(\$203,735,410)	(\$354,114,786)	(\$474,674,955)

ESTIMATED NET EFFECT ON OTHER STATE FUNDS				
FUND AFFECTED	FY 2022	FY 2023	FY 2024	Fully Implemented (FY 2027)
Total Estimated Net Effect on <u>Other</u> State Funds	\$0	\$0	\$0	\$0

Numbers within parentheses: () indicate costs or losses.

ESTIMATED NET EFFECT ON FEDERAL FUNDS				
FUND AFFECTED	FY 2022	FY 2023	FY 2024	Fully Implemented (FY 2027)
Total Estimated Net Effect on All Federal Funds	\$0	\$0	\$0	\$0

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)				
FUND AFFECTED	FY 2022	FY 2023	FY 2024	Fully Implemented (FY 2027)
General Revenue – DOR	3 FTE	3 FTE	3 FTE	3 FTE
General Revenue - DOP	2 FTE	2 FTE	2 FTE	2 FTE
Total Estimated Net Effect on FTE	5 FTE	5 FTE	5 FTE	5 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	Fully Implemented (FY 2027)
Local Government	\$0	\$0	\$0	\$0

FISCAL ANALYSIS

ASSUMPTION

Officials from the **Office of Administration – Budget & Planning Division (B&P)** state this proposed legislation will decrease Total State Revenue (TSR) by \$474,317,977 once fully implemented.

B&P states this proposed legislation will impact the calculation under Article X, Section 18(e).

Section 34.195 – State Contracts

Oversight notes this section states that five percent (5%) of all state contracts shall be awarded to businesses that have been in operation for less than five (5) years.

Officials from the **Office of Administration – Division of Purchasing (DOP)** state DOP would have to change CSRs, develop internal procedures, provide training, update state agencies, and track/monitor the requirement.

DOP anticipates it would take two (2) staff with 480 hours each to change CSRs, develop internal procedures, provide training, and update state agencies.

Additionally, DOP would be required to monitor the requirement. DOP anticipates needing two (2) FTE to manage and monitor the requirement. One (1) FTE would be a professional position as a Procurement Specialist and one would be support staff as an Administrative Support Assistant.

Oversight assumes DOP can absorb the cost associated with changing CSRs, developing internal procedures, providing training, and updating state agencies with existing resources.

Oversight will include DOP's two (2) FTE for managing and monitoring the requirement created under this section.

Officials from **B&P** state this section would require that 5% of state contracts be awarded to businesses in operation for less than five years beginning July 1, 2022.

Officials from the **Missouri Department of Revenue (DOR)** state this section will not cause a fiscal impact on DOR.

Section 143.022 & 143.071 – New Business Income Tax

Officials from **B&P** and **DOR** state this proposed legislation would tax pass-through business income in a separate manner from other individual income for new businesses created after January 1, 2022. B&P and DOR note that this would apply to S-corporations, Sole Proprietorships, Partnerships, and Limited Liability Companies (LLCs).

This proposed legislation creates tax brackets and tax rates for qualifying businesses. Table 1 shows the income brackets and tax rates by tax year for businesses started in Tax Year 2022.

Table 1: Income Thresholds for Taxation for Pass-Through Businesses started in Tax Year 2022

Years of Operation	Lower Income	Tax Rate**	Higher Income	Tax Rate**
1	\$125,000	0.000%	\$250,001	5.3%
2	\$500,000	3.313%	\$500,001	5.3%
3	\$750,000	3.975%	\$750,001	5.3%
4	\$1,000,000	4.550%	\$1,000,001	5.2%
5	all income			5.1%

*This is only the tax structure for businesses started in 2022.

**The estimates for current taxes accounts for the top rate reductions and business income exemptions under SB 509 (2014).

This proposed legislation would create a new corporate business income tax structure for corporations created after January 1, 2022. B&P and DOR note that this would apply to C-corporations.

This proposed legislation creates tax brackets and tax rates for qualifying businesses. Table 2 shows the income brackets and tax rates by tax year.

Table 2: Income Thresholds for Taxation for Corporations

Years of Operation	Lower Income	Tax Rate	Higher Income	Tax Rate
1	\$250,000	0.0%	\$250,001	4.0%
2	\$500,000	1.0%	\$500,001	4.0%
3	\$750,000	2.0%	\$750,001	4.0%
4	\$1,000,000	3.0%	\$1,000,001	4.0%
5	all income			4.0%

Background Data

Based on the 2017 Annual Business Survey (the most complete year available) published by the U.S. Census Bureau there were 18,032 firms in business for less than two years in Missouri, 15,104 firms in business for 2 to 3 years, and 10,637 firms in business for four to five years. Table 3 shows the number of firms by length of operations.

Table 3: Business in Missouri

Years of Operation	Number of firms	Average Annual Revenue
< 2	18,032	\$520,550
2 to 3	15,104	\$639,351
4 to 5	10,637	\$1,013,027
6 to 10	16,808	\$1,341,666
11 to 15	16,568	\$1,864,366
> 15	39,007	\$15,337,429

Based on information published by the National Small Business Association, approximately 35% of small businesses are LLCs, 33% are S-Corporations, 19% are C-Corporations, 12% are Sole Proprietorships, and 2% are Partnerships. Table 4 shows the estimated number of firms for each formation type.

Table 4: Estimated Businesses by Formation

Years of Operation	Number of firms	LLC (35%)	S-Corp (33%)	C-Corp (19%)	Sole Proprietor (12%)	Partnerships (2%)
< 2	18,032	6,275	5,914	3,390	2,128	325
2 to 3	15,104	5,256	4,954	2,840	1,782	272
4 to 5	10,637	3,702	3,489	2,000	1,255	191
6 to 10	16,808	5,849	5,513	3,160	1,983	303
11 to 15	16,568	5,766	5,434	3,115	1,955	298
> 15	39,007	13,574	12,794	7,333	4,603	702
Total	116,156	40,422	38,098	21,838	13,706	2,091

Corporate Income Tax

B&P and DOR note that as of January 1, 2020, the corporate tax rate under Section 143.071, RSMo, is 4.0%. Using the information above, B&P and DOR estimates that this provision will reduce an individual firm's income tax by \$10,000 to \$15,000 per year in the first four years of operation. Table 5 shows the estimated impact per firm.

Table 5: Corporate Income Tax Impacts

Year of Operation	Number of Businesses	Current Estimated Taxes	Proposed Estimated Taxes	Difference in Taxes Owed
1	3,390	\$20,822	\$10,822	(\$10,000)
2	2,840	\$25,574	\$10,574	(\$15,000)
3	2,840	\$25,574	\$10,574	(\$15,000)
4	2,000	\$40,521	\$30,521	(\$10,000)
5	2,000	\$40,521	\$40,521	\$0

To account for the number of business closures within the first five years of operation, B&P and DOR utilized the number of firms operating less than 2 years, between 2 and 3 years, and between 4 and 5 years. B&P and DOR estimates that in total, this provision will reduce corporate income taxes by \$139.1 million annually by Tax Year 2025. Table 6 shows the estimated impact by tax year.

Table 6: Corporate
Income Tax Loss by
Tax Year

Tax Year	GR Loss
2022	(\$33,900,000)
2023	(\$76,500,000)
2024	(\$119,100,000)
2025	(\$139,100,000)
2026	(\$139,100,000)

However, because this proposal would begin at the beginning of a firm's tax year, the corporations will adjust their declarations payments during the first fiscal year. Based on historical revenue receipts, B&P and DOR estimates that 50% of corporate income taxes are remitted during Fiscal Year 1 and 50% are remitted during Fiscal Year 2. Therefore, B&P and DOR estimates that this provision will reduce TSR and GR by \$17.0 million in Fiscal Year 2022. Once fully implemented in Fiscal Year 2027, this proposal will reduce TSR and GR by \$139.1 million annually. Table 7 shows the estimated impact by fiscal year.

Table 7: Corporate
Income Tax Loss by
Fiscal Year

Fiscal Year	GR Loss
2022	(\$16,950,000)
2023	(\$55,200,000)
2024	(\$97,800,000)
2025	(\$129,100,000)
2026	(\$139,100,000)
2027	(\$139,100,000)

Individual Income Tax

B&P and DOR note that LLCs, S-Corporations, Sole Proprietorships, and Partnerships are all “pass-through” entities. Owners of such firms report business income on their individual income tax form and not on a corporate income tax form. B&P and DOR further note that the individual income tax rate is currently 5.4%, with three additional 0.1% reductions scheduled to occur pending growth in net GR.

In addition, Section 143.022, RSMo, grants pass-through businesses and income exemption on a portion of their business income. B&P and DOR notes that currently 10% of pass-through business income is exempt from taxation, with two more 5% increases scheduled to occur pending net GR growth. B&P and DOR further notes that under this proposal, newly created pass-through businesses would still be allowed to use this income exemption.

Based on current revenue forecasts and average revenue growth, B&P and DOR estimates 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 and increased business exemption. Therefore, the top rate of tax will be reduced by 0.1% in Tax Year(s) 2022, 2025, and 2026 and the business income exemption will increase by 5% in Tax Year(s) 2022 and 2025 under SB 509 (2014).

Accounting for changes scheduled to occur; B&P and DOR estimates that this provision will reduce per firm taxes owed by \$5,268 to \$9,938 per year for businesses started in Tax Year 2022. B&P and DOR note that businesses started in future years would face a different income tax structure due to the rate reduction and income exemption increase scheduled to occur under SB 509 (2014). Table 8 shows the estimated impact for firms established in Tax Year 2022.

Table 8: Pass-Through Income Tax Impacts for Businesses Started in Tax Year 2022*

Year of Operation	Number of Businesses	Current Estimated Taxes**	Proposed Estimated Taxes**	Difference in Taxes Owed
1	14,642	\$23,451	\$16,826	(\$6,625)
2	12,264	\$28,803	\$18,865	(\$9,938)
3	12,264	\$28,803	\$21,602	(\$7,201)
4	8,637	\$42,142	\$36,874	(\$5,268)
5	8,637	\$42,142	\$42,142	\$0

*This is only the tax structure for businesses started in 2022.

**The estimates for current taxes accounts for the top rate reductions and business income exemptions under SB 509 (2014).

***The estimates for proposed taxes accounts for the business income exemptions under SB 509 (2014).

To account for the number of business closures within the first five years of operation, B&P and DOR utilized the number of firms operating less than 2 years, between 2 and 3 years, and between 4 and 5 years. B&P and DOR estimates that in total, this provision will reduce individual income taxes by \$335.2 million annually by Tax Year 2026. Table 9 shows the estimated impact by tax year.

Table 9: Individual Income Loss by Tax Year

Tax Year	GR Loss
2022*	(\$97,003,250)
2023	(\$218,876,750)
2024	(\$307,185,963)
2025*	(\$341,790,879)
2026*	(\$335,217,977)

*Assumes that SB 509 (2014) rate reduction and business income exemption increase occurs

However, because this proposal would begin at the beginning of a firm's tax year, individuals will adjust their withholdings and declarations during the first fiscal year. Based on historic revenue patterns, 42% of individual income taxes are remitted during Fiscal Year 1 and 58% are remitted during in Fiscal Year 2. Therefore, B&P and DOR estimates that this provision will reduce TSR and GR by \$40.7 million in Fiscal Year 2022. Once fully implemented in Fiscal Year 2027, this proposal will reduce TSR and GR by \$335.2 million annually. Table 10 shows the estimated impact by fiscal year.

Table 10: Individual
Income Loss by Fiscal
Year

Fiscal Year	GR Loss
2022	(\$40,741,365)
2023	(\$148,190,120)
2024	(\$255,966,620)
2025	(\$321,720,028)
2026	(\$339,030,260)
2027	(\$335,217,977)

Summary

B&P and DOR estimates that this provision will reduce TSR and GR by \$57.7 million in Fiscal Year 2022. Once fully implemented, in Fiscal Year 2027 this provision will reduce TSR and GR by \$474.3 million annually. Table 11 shows the estimated impact by fiscal year.

Table 11: Summary of
GR Impact

Fiscal Year	GR Loss
2022	(\$57,691,365)
2023	(\$203,390,120)
2024	(\$353,766,620)
2025	(\$450,820,028)
2026	(\$478,130,260)
2027	(\$474,317,977)

Officials from **DOR** state this proposed legislation would require an entire separate regime to impose a separate rate of taxes. This would involve programming changes and possible new FTEs. This proposed legislation requires DOR have the burden of ensuring compliance to determine which year of operation the business is in. There currently are not any solid resources to confirm that determination. New forms, programming and staff would be needed. At this time the exact fiscal impact is unknown.

DOR anticipates that this proposed section would require a totally new program that would require DOR to contract with a provider. DOR believes the fiscal impact for this could be greater than \$1 million. DOR will continue to research and update when needed.

DOR assumes it will need at least 3 additional Auditors to start. Depending on the number of audits required to ensure compliance, the number of auditors could increase in future years.

For purposes of this fiscal note, **Oversight** will report the impact to GR as a result of the Income Tax changes, as reported by B&P.

In addition, for the purposes of this fiscal note, Oversight will report the \$1 million contract cost and the three (3) FTE Auditors required by the Missouri Department of Revenue. Oversight notes the \$1 million will be included in DOR's equipment & expense.

Section 431.203 – Non-Compete Agreements

Officials from **B&P** state this section would prohibit non-compete agreements beginning August 28, 2021 if an employee earns \$90,000 or less from an employer. This section will not impact TSR or the calculation under Article X, Section 18(e).

Officials from the **DOR** do not anticipate this section will result on 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 as it relates to this section.

Section 620.3800 – Office of Entrepreneurship

Officials from **B&P** state this section would create the “Office of Entrepreneurship” under the Missouri Department of Economic Development. The office shall promote policies and initiatives to support entrepreneurship within Missouri.

Officials from the **DOR** do not anticipate this section will result on 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 as it relates to this section.

Legislation as a Whole -

In response to the previous version of this proposed legislation, officials from the **Office of the Secretary of State (SOS)** noted many bills considered by the General Assembly include provisions allowing or requiring agencies to submit rules and regulations to implement the act. 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 \$5,000. SOS recognizes that this is a small amount and does not expect that additional funding would be required to meet these costs. However, SOS also recognizes 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 SOS can sustain with SOS's core budget. Therefore, SOS reserves 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.

Oversight assumes the SOS could absorb the costs of printing and distributing regulations related to this proposed legislation. If multiple bills pass which require the printing and distribution of regulations at substantial costs, the SOS could request funding through the appropriations process.

In response to the previous version of this proposed legislation, officials from the **Joint Committee on Administrative Rules** assumed this proposal is not anticipated to cause a fiscal impact beyond its current appropriation.

Oversight assumes JCAR will be able to administer any rules from this proposed legislation with existing resources.

Officials from the **City of Claycomo**, the **City of Corder**, the **City of Kansas City**, and the **City of Springfield** 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 these organizations.

In response to the previous version of this proposed legislation, officials from the **Missouri Department of Economic Development**, the **Missouri Department of Agriculture**, and the **Missouri Department of Transportation** did not anticipate this proposed legislation would cause a fiscal impact on their organizations. Oversight does not have any information to the contrary. Therefore, Oversight will not report a fiscal impact for this organizations.

<u>FISCAL IMPACT</u> – State Government	FY 2022 (10 Mo.)	FY 2023	FY 2024	Fully Implemented (FY 2027)
GENERAL REVENUE FUND				
<u>Revenue Reduction</u> – Section(s) 143.073 & 143.513 – Income Tax Changes p. 4-9	(\$57,691,365)	(\$203,390,120)	(\$353,766,620)	(\$474,317,977)
<u>Cost – OA-DOP</u>				
Personnel Services	(\$63,307)	(\$76,728)	(\$77,728)	(\$79,843)
Fringe Benefits	(\$41,266)	(\$49,776)	(\$50,035)	(\$50,827)
Equipment & Expense	<u>(Unknown)</u>	<u>(Unknown)</u>	<u>(Unknown)</u>	<u>(Unknown)</u>
Total Cost – DOP p. 3	Greater than (\$104,573)	Greater than (\$126,504)	Greater than (\$127,530)	Greater than (\$130,670)
FTE Change - DOP	2 FTE	2 FTE	2 FTE	2 FTE
<u>Cost – DOR</u>				
Personnel Services	(\$111,960)	(\$135,696)	(\$137,052)	(\$141,205)
Fringe Benefits	(\$67,637)	(\$81,617)	(\$82,075)	(\$83,477)
Equipment & Expense	<u>(\$1,129,134)</u>	<u>(\$1,473)</u>	<u>(\$1,509)</u>	<u>(\$1,626)</u>
Total Cost – DOR	<u>(\$1,308,731)</u>	<u>(\$218,786)</u>	<u>(\$220,636)</u>	<u>(\$226,308)</u>
FTE Change – DOR p. 9-10	3 FTE	3 FTE	3 FTE	3 FTE
ESTIMATED NET EFFECT ON GENERAL REVENUE FUND	<u>(\$59,104,669)</u>	<u>(\$203,735,410)</u>	<u>(\$354,114,786)</u>	<u>(\$474,674,955)</u>

<u>FISCAL IMPACT – Local Government</u>	FY 2022 (10 Mo.)	FY 2023	FY 2024	Fully Implemented (FY 2027)
	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>

FISCAL IMPACT – Small Business

This proposed legislation could impact any small business that would qualify for the modified income tax schedule/brackets created under this proposed legislation.

FISCAL DESCRIPTION

This proposed legislation states that five percent (5%) of all state contracts shall be awarded to businesses that have been in operation for less than five (5) years.

This proposed legislation creates a new tax schedule/brackets for specific businesses and income.

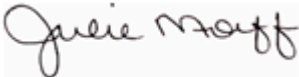
This proposed legislation would prohibit non-compete agreements beginning August 28, 2021 if an employee earns \$90,000 or less from an employer.

This proposed legislation would create the “Office of Entrepreneurship” under the Missouri Department of Economic Development. The office shall promote policies and initiatives to support entrepreneurship within Missouri.

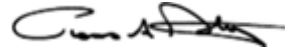
This legislation is not federally mandated, would not duplicate any other program and would not require additional capital improvements or rental space.

SOURCES OF INFORMATION

Office of Administration – Budget & Planning Division
Office of Administration – Division of Purchasing
Missouri Department of Revenue
Missouri Department of Agriculture
Missouri Department of Economic Development
Missouri Department of Transportation
Missouri Secretary of State
Joint Committee on Administrative Rules
City of Claycomo
City of Corder
City of Kansas City
City of Springfield



Julie Morff
Director
March 18, 2021



Ross Strobe
Assistant Director
March 18, 2021