

COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 2454H.03P
Bill No.: Perfected 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: April 29, 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	Could exceed (\$59,179,828)	Could exceed (\$203,821,524)	Could exceed (\$354,201,726)	Could exceed (\$474,764,440)
Total Estimated Net Effect on General Revenue	Could exceed (\$59,179,828)	Could exceed (\$203,821,524)	Could exceed (\$354,201,726)	Could exceed (\$474,764,440)

*Oversight assumes Section 620.2005 (HSA 1 to HA 2) may increase the number of projects that qualify under the Missouri Works Program and therefore increase the amount of benefits awarded. Oversight assumes the increased benefits awarded could exceed \$250,000. Oversight assumes there would be some positive economic benefit to the state if some retail establishments are now allowed to utilize the Missouri Works Program; however, Oversight considers these to be indirect impacts of the legislation and will not reflect them in the fiscal note.

Numbers within parentheses: () indicate costs or losses.

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

ESTIMATED NET EFFECT ON FEDERAL FUNDS				
FUND AFFECTED	FY 2022	FY 2023	FY 2024	Fully Implemented (FY 2027)
Total Estimated Net Effect on <u>All</u> 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 – OA	2 FTE	2 FTE	2 FTE	2 FTE
General Revenue - DOR	3 FTE	3 FTE	3 FTE	3 FTE
General Revenue – DED	1 FTE	1 FTE	1 FTE	1 FTE
Total Estimated Net Effect on FTE	6 FTE	6 FTE	6 FTE	6 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.

In response to the previous version of this proposed legislation, officials from the **Office of Administration (OA) – Division of Purchasing (DOP)** stated DOP would have to change Code of State Regulations (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 (1) would be support staff as an Administrative Support Assistant.

Oversight will include DOP's two (2) FTE as estimated.

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.

Section 143.022 & 143.071 – New Business Income Tax

Officials from **B&P** and the **Missouri Department of Revenue (DOR)** state Subsection 143.022.8 exempts a certain portion of income based on years of operation, beginning with Tax Year 2022. Table 1 shows the income exempted for businesses started in Tax Year 2022.

Table 1: Exempted Income

Year of Operation	Income Limit	% Exempt	\$ Exempt
1	\$250,000	50.0%	\$125,000
2	\$500,000	37.5%	\$187,500
3	\$750,000	25.0%	\$187,500
4	\$1,000,000	12.5%	\$125,000

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 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 estimate 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 estimate 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 estimate 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 note 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 note 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 estimate 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 estimate 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 estimate 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 estimate 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 estimate 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 the **Missouri Department of Revenue (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 to administer this could be greater than \$1 million. DOR will continue to research and update when needed.

DOR assumes it will need at least three (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 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.

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.

Section 431.203 – Non-Compete Agreements

Oversight notes this section would prohibit non-compete agreements, beginning with the effective date of this section, if an employee or prospective employee receives seventy-five thousand dollars or less in income from such employer or prospective employer, or the employee is employed by an employer working on a contract with the United States Department of Defense.

Oversight does not anticipate this section will result in a direct fiscal impact. Therefore, Oversight will not report a fiscal impact for this section.

Officials from **B&P** state this section would prohibit non-compete agreements beginning August 28, 2021 if an employee earns \$75,000 or less from an employer. This section will not impact TSR or the calculation under Article X, Section 18(e).

Section 620.2005 – Missouri Works Program

Oversight notes this section modifies the definition of "Qualified Company".

Currently, the definition of "Qualified Company" states the term shall not include: store front consumer-based retail trade establishments (under NAICS Sectors 44 and 45), except with respect to any company headquartered in this state with a majority of its full time employees engaged in operations not within the NAICS codes specified in this subdivision.

This section modifies the definition so that store front consumer based retail trade establishments located in a county of the third or fourth class **could** qualify as a "Qualified Company".

Oversight notes, per the most recent Tax Credit Analysis submitted by the Missouri Department of Economic Development, the Missouri Works Program had the following activity:

Fiscal Year	2018	2019	2020	2021 (Estimate)	2022 (Budget Year)
Certificates Issued (#)	31	50	54	61	80
Projects/Participants	141	101	116	119	119
Amount Authorized	\$185,732,973	\$105,043,020	\$153,823,786	\$148,199,926	\$148,199,926
Amount Issued	\$45,830,250	\$82,326,472	\$134,393,278	\$188,341,232	\$181,272,564
Amount Redeemed	\$56,398,909	\$64,786,980	\$113,472,125	\$169,507,109	\$163,145,308

Oversight notes the three (3) year average amount authorized totals \$148,199,926. The three (3) year average amount issued totals \$87,516,667.

Oversight notes the three (3) year average number of certificates issued totals 45. The three (3) year average number of projects/participants totals 119.

Oversight notes, when dividing the three (3) year average amount authorized **or** issued by the three (3) year average number of certificates **or** projects/participants, the average amount authorized **or** issued **per taxpayer** is in excess of \$250,000.

Therefore, for purposes of this fiscal note, **Oversight** will report a revenue reduction equal to \$0 (participation in MO Works Program does not increase as a result of the change) to a negative “Unknown” as the result of an increase in participation of the MO Works Program as a result of the changes made to the definition of Qualified Company.

Oversight assumes this section will become effective August 28, 2021 (Fiscal Year 2022). Therefore, Oversight will report the aforementioned impact as a result of this section beginning in Fiscal Year 2022.

In response to similar legislation (HB 1061 – 2021), officials from the **Missouri Department of Economic Development** did 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 for this section.

Officials from **B&P** state this section would allow storefront retailers to be considered qualified companies in counties of the third and fourth class. In the event that this change leads to higher utilization of MO Works tax credits, this section could reduce TSR and GR by an unknown amount beginning in Fiscal Year 2022.

Section 620.3800 – Office of Entrepreneurship

Oversight notes this section establishes the “Office of Entrepreneurship” within the Missouri Department of Economic Development. The Office of Entrepreneurship shall employ an individual to promote policies and initiatives to support the growth of entrepreneurship in the state. The Office of Entrepreneurship shall work with stakeholders and communities to provide information and technical support to entrepreneurs.

In response to a previous version of this proposed legislation, officials from the **Missouri Department of Economic Development (DED)** stated this section creates the “Office of Entrepreneurship” within DED. Since DED is responsible for administering the Office of Entrepreneurship, DED will require one (1) FTE Senior Economic Development Specialist.

Oversight notes this section states the Office of Entrepreneurship (the Missouri Department of Economic Development) shall employ an individual. Therefore, Oversight will include the Missouri Department of Economic Development’s administrative impact(s), as estimated by the Missouri Department of Economic Development.

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.

Legislation as a Whole

Officials from the **Missouri State Treasurer’s Office**, 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 organizations. Oversight does not have any information to the contrary. Therefore, Oversight will not report a fiscal impact for these organizations.

<u>FISCAL</u> <u>IMPACT – State</u> <u>Government</u>	FY 2022 (10 Mo.)	FY 2023	FY 2024	Fully Implemented (FY 2027)
<u>Revenue</u> <u>Reduction –</u> Section(s) 143.073 & 143.513 – Income Tax Changes – p. 5-160	(\$57,691,365)	(\$203,390,120)	(\$353,766,620)	(\$474,317,977)
<u>Cost – OA-DOP</u> – Section 34.195				
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. 4	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> Section(s) 143.022 & 143.071				
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 – p. 10-11	(\$1,308,731)	(\$218,786)	(\$220,636)	(\$226,308)
FTE Change – DOR	3 FTE	3 FTE	3 FTE	3 FTE

<u>Revenue Reduction</u> – Section 620.2005 – Change In Definition Of “Qualified Company” – p. 11-12	\$0 to (Unknown)	\$0 to (Unknown)	\$0 to (Unknown)	\$0 to (Unknown)
<u>Cost</u> – DED – Section 620.3800				
Personnel Services	(\$42,218)	(\$51,168)	(\$51,679)	(\$53,245)
Fringe Benefits	(\$24,199)	(\$29,209)	(\$29,382)	(\$29,910)
Equipment & Expense	(\$8,742)	(\$5,737)	(\$5,879)	(\$6,330)
Total Cost – DED – p. 13	(\$75,159)	(\$86,114)	(\$86,940)	(\$89,485)
FTE Change - DED	1 FTE	1 FTE	1 FTE	1 FTE
ESTIMATED NET EFFECT ON GENERAL REVENUE FUND	<u>Could exceed</u> (\$59,179,828)	<u>Could exceed</u> (\$203,821,524)	<u>Could exceed</u> (\$354,201,726)	<u>Could exceed</u> (\$474,764,440)

<u>FISCAL IMPACT</u> – <u>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 a small business that is a store front consumer-based retail trade establishment as such company could potentially qualify for the Missouri Works Program benefits.

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

FISCAL DESCRIPTION

This bill provides that store front consumer-based retail trade establishments located in any county of the third or fourth classification may qualify for benefits under the Missouri Works Program.

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.

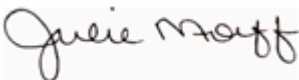
This proposed legislation would prohibit non-compete agreements beginning August 28, 2021 if an employee earns \$75,000 or less from an employer.

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
Office of Administration – Division of Purchasing
Missouri Department of Revenue
Missouri Department of Economic Development
Missouri State Treasurer's Office
City of Claycomo
City of Corder
City of Kansas City
City of Springfield



Julie Morff
Director
April 29, 2021



Ross Strobe
Assistant Director
April 29, 2021