COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 2117H.02P
Bill No.: Perfected HCS for HB 1023
Subject: Agriculture; Department of Agriculture; Department of Revenue; Tax Incentives; Taxation and Revenue - General
Type: Original
Date: April 18, 2023

Bill Summary: This proposal allows subtractions from Missouri adjusted gross income for agriculture-related tax deductions.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2024	FY 2025	FY 2026
General Revenue	($2,348,775 to $11,990,137)	($2,221,956 to $11,571,156)	($2,216,423 to $11,370,848)
Total Estimated Net Effect on General Revenue	**($2,348,775 to $11,990,137)**	**($2,221,956 to $11,571,156)**	**($2,216,423 to $11,370,848)**

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2024	FY 2025	FY 2026
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 2024	FY 2025	FY 2026
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2024	FY 2025	FY 2026
Total Estimated Net Effect on FTE	**0**	**0**	**0**

☒ 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 2024	FY 2025	FY 2026
Local Government	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

Due to time constraints, **Oversight** was unable to receive some agency responses in a timely manner and performed limited analysis. Oversight has presented this fiscal note on the best current information that we have or on information regarding a similar bill(s). Upon the receipt of agency responses, Oversight will review to determine if an updated fiscal note should be prepared and seek the necessary approval to publish a new fiscal note.

Section 143.022 HA 2 - Business Income Exemption

Officials from the **Department of Revenue (DOR)** note this proposal attempts to add the income of farmers as reported on two specific IRS forms to the business exemption. Those forms are the Schedule F and Form 4835. It should be noted the income reported on Form 4835 is reported onto the Schedule E which is already exempt per statutes.

The Department used its internal Income Tax Model that contains confidential taxpayer data to calculate the fiscal impact. SB 3 adopted in 2022, lowered the individual income tax rate to 4.95% starting January 1, 2023, and additionally is projected to lower the current tax rate down to 4.5% over a period of years based on revenue growth. DOR will show the impact through the implementation period.

The Department notes that this income is reported at the time of filing of the return and will result in a loss to general revenue:

Tax Year (Fiscal Year)	Amount
2023 (FY 2024)	($2,160,600)
2024 (FY 2025)	($2,155,065)
2025 (FY 2026)	($2,102,909)
2026 (FY 2027)	($2,055,404)
2027 (FY 2028)	($2,014,848)

This proposal will require modification to the MO-A form and to the MO-1040 form. Additionally, DOR will need to modify their website and their individual income tax computer system. These changes are estimated to cost $7,193.

Oversight assumes the Department of Revenue is provided with core funding to handle a certain amount of activity each year. Oversight assumes the DOR could absorb the administrative costs related to this proposal. If multiple bills pass which require additional staffing and duties at substantial costs, DOR could request funding through the appropriation process.

In response to a similar proposal, Perfected HS for HCS for HB 356 (2023), officials from the **Office of Administration - Budget and Planning (B&P)** note this proposal would add

Schedule F (farm income) and Form 4835 to the list of income types included within the business income exemption. B&P notes that Form 4835 is for farm rental income, which is included within Schedule E and is therefore already included within the existing exemption. Therefore, this proposal will only add Schedule F to the business income exemption.

B&P further notes that the business income exemption was fully implemented for tax year 2023, with a total exemption allowance of 20%. In addition, this proposal will start on August 28, 2023. Therefore, B&P assumes that the exemption would apply to tax year 2023 income.

Using tax year 2020 data, the most recent and complete year available, and accounting for SB 3 (2022), B&P estimates that this provision may reduce TSR and GR by $2,263,751 in FY24. Once SB 3 (2022) has fully implemented, B&P estimates that this provision could reduce TSR and GR by $2,024,840 annually. Table 1 shows the estimated impact by year.

Table 1: Estimated Impact by Year

Tax Year	Fiscal Year	GR Loss
2023	2024	($2,263,751)
2024	2025	($2,163,156)
2025	2026	($2,158,848)
2026	2027	($2,111,498)
2027	2028	($2,067,217)
2028	2029	($2,024,840)

Section 143.121 Farm Owner Gross Income Subtractions

In response to a previous version (HCS HB 1023), officials from the **Office of Administration - Budget and Planning (B&P)** noted this proposal would grant an income tax subtraction to farm owners that sell, lease, or enter crop-sharing agreements with beginning farmers or qualified family members. B&P notes that this proposal would become effective August 28, 2023, which is in the middle of tax year 2023. Therefore, B&P assumes that this subtraction would be available for tax year 2023 income tax returns.

This proposal would allow farmers who sell land to a beginning farmer or qualified family member to subtract the realized capital gains from their Missouri Adjusted Gross Income (MAGI) up to $4,000,000 per year. Farmers who enter into lease or crop-share agreements may subtract related income from their MAGI, up to $25,000 per year.

Beginning farmers are defined as individuals who have filed up to ten Schedule F returns since turning 18 and have been approved for a beginning farmer loan through the USDA. Beginning farmers is also defined to include qualified family members, regardless of how long such individual has operated a farm.

According to the USDA, there were 493 beginning farmers with loans through one of their beginning farmer loan programs. B&P notes that beginning farmers are those who have operated a farm for one to ten years. For the purpose of this fiscal note, B&P will assumes that 1/10 of the 493 began operations each year. Therefore, B&P assumes that approximately 49 new sale/lease/crop-share agreements may occur each year. B&P notes that additional individuals may qualify under this proposal as a qualified family member. B&P is unable to estimate the number of qualified family members.

B&P does not know much capital gains are realized each year or the income associated with lease/crop-share agreements. Therefore, B&P will estimate the total potential impact using the limits allowed in this proposal. This proposal would allow a percent of the capital gains to be subtracted, based on the amount of capital gains realized. For total capital gains of up to $6 million, a qualifying taxpayer may subtract up to $4 million. Table 1 shows the allowable subtraction by capital gain amount.

Table 1: Allowable Capital Gains Subtraction

Capital Gains	Subtraction %	Allowable Subtraction
First $2 million	100%	up to $2,000,000
Next $1 million	80%	up to $800,000
Next $1 million	60%	up to $600,000
Next $1 million	40%	up to $400,000
Next $1 million	20%	up to $200,000
Up to $6 million		up to $4,000,000

Assuming all farmers enter into leasing or crop-sharing agreements, B&P estimates that this proposal could exempt up to $1,225,000 (49 agreements x $25,000 limit) in income annually. If all farmers were to sell land to beginning farmers, this proposal could exempt up to $196,000,000 ($4,000,000 x 49 sales) in income each year. However, subtractions do not reduce revenues on a dollar for dollar basis, rather in proportion to the top tax rate applied. Therefore, B&P will show the estimated impacts throughout the implementation of SB 3 (2022).

Table 1: Revenue Loss by Year

	Tax Year (Fiscal Year)					
Tax Rate	2023 (FY24)		2024 (FY25)		2025 (FY26)	
	Low	High	Low	High	Low	High
4.95%	($60,638)	($9,702,000)	($60,638)	($9,702,000)	($60,638)	($9,702,000)
4.80%			($58,800)	($9,408,000)	($58,800)	($9,408,000)
4.70%					($57,575)	($9,212,000)
4.60%						
4.50%						

Table 1: Revenue Loss by Year

	Tax Year (Fiscal Year)			
Tax Rate	2026 (FY27)		2027 (FY 28)	
	Low	High	Low	High
4.95%	($60,638)	($9,702,000)	($60,638)	($9,702,000)
4.80%	($58,800)	($9,408,000)	($58,800)	($9,408,000)
4.70%	($57,575)	($9,212,000)	($57,575)	($9,212,000)
4.60%	($56,350)	($9,016,000)	($56,350)	($9,016,000)
4.50%			($55,125)	($8,820,000)

Therefore, B&P estimates that this proposal could reduce TSR and GR by up to $60,638 to $9,702,000 in FY24. Once SB 3 (2022) has fully implemented, this proposal may reduce TSR and GR by up to $55,125 to $8,820,000 annually.

Officials from the **Department of Revenue (DOR)** note this proposal in Section 143.121.10 creates new subtractions from MAGI of the capital gains, rental income and crop-share agreements income reported in a qualified taxpayer's federal adjusted gross income. These subtractions would be available to a farm owner who sells their whole/part of their property to a beginning farmer, rents to a beginning farmer or enters into a crop-share agreement with a beginning farmer. A qualified taxpayer may claim a percentage based on the amount of the first capital gains received:

For the first $2 million – 100%	($2,000,000)
For the next $1 million – 80%	($800,000)
For the next $1 million - 60%	($600,000)
For the next $1 million - 40%	($400,000)
For the next $1 million – 20%	($200,000)
	($4,000,000)

The maximum amount a taxpayer could receive in a subtraction is $4 million. Farmers who enter into lease or crop-share agreements may subtract related income from their MAGI, up to $25,000 per year.

To be consider a beginning farmer under this proposal, the farmer must be approved for a loan from the USDA Farm Service Agency and have filed at least one but less than 10 IRS Schedule F returns. The USDA Farm Service Agency reports there are 493 beginning farmers with a loan in MO. Since the farmer must have filed less than 10 IRS annual returns, DOR will assume there are 49 new farmers annually.

The Department is unable to determine the amount of capital gains realized by taxpayers who sell their farmland, or the amount of income received from lease/crop-share agreements. Therefore, DOR will show the estimates based on the limits in the proposal. If all farmers entered into a leasing or crop-sharing agreement, this would exempt $1,225,000 (49 beginning farmers * $25,000 limit) annually. If all those farmers decided to sell their property and reached the maximum subtraction it would exempt up to $196,000,000 (49 beginning farmers * $4,000,000 capital gains limit).

Subtractions do not reduce revenue on a dollar for dollar basis but based on the top income rate applied. SB 3 (2022) has set the individual income tax rate at 4.95% for tax year 2023 and is expected to reduce the rate to 4.5% over a series of years based on certain revenue triggers. DOR will show the loss to general revenue based on the variable future tax rates.

Revenue Loss by Year

	Tax Year (Fiscal Year)					
Tax Rate	2023 (FY24)		2024 (FY25)		2025 (FY26)	
	Low	High	Low	High	Low	High
4.95%	($60,638)	($9,702,000)	($60,638)	($9,702,000)	($60,638)	($9,702,000)
4.80%			($58,800)	($9,408,000)	($58,800)	($9,408,000)
4.70%					($57,575)	($9,212,000)
4.60%						
4.50%						

Revenue Loss by Year

	Tax Year (Fiscal Year)			
Tax Rate	2026 (FY27)		2027 (FY 28)	
	Low	High	Low	High
4.95%	($60,638)	($9,702,000)	($60,638)	($9,702,000)
4.80%	($58,800)	($9,408,000)	($58,800)	($9,408,000)
4.70%	($57,575)	($9,212,000)	($57,575)	($9,212,000)
4.60%	($56,350)	($9,016,000)	($56,350)	($9,016,000)
4.50%			($55,125)	($8,820,000)

This proposal will require DOR to add a new line on the MO-1040, the MO-1120 and the MO-PTE. DOR would also need to update their website and individual income tax computer systems. This would result in costs of $7,193.

Additionally, while the Department of Agriculture is tasked with establishing a process to verify if the beginning farmer meets the qualification stated in this proposal, and providing that famer with confirmation of that qualification, DOR assumes they will have to create the confirmation form. DOR's tax returns and all schedules and attachments are designed to go through their electronic tax computer system. Setting up this confirmation form will result in additional costs of $10,000.

Responses regarding the proposed legislation as a whole

Oversight will show the cost of system, forms, and website modifications for all sections in this proposal estimated at $24,386 by DOR as a one-time cost in FY 2024.

Oversight notes officials from B&P and DOR both assume the proposal will have a negative fiscal impact on general revenue. Oversight will show B&P and DOR's projected fiscal estimated impacts of this proposal throughout the implementation of the tax rate reductions from SB 3 (2022) to show the maximum low and high impact of the proposal. The fiscal note reflects the assumptions that the SB 3 (2022) reductions are triggered consecutively

Rule Promulgation

Officials from the **Joint Committee on Administrative Rules** assume this proposal is not anticipated to cause a fiscal impact beyond its current appropriation.

Officials from the **Office of the Secretary of State (SOS)** note many bills considered by the General Assembly include provisions allowing or requiring agencies to submit rules and regulations to implement the act. The 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 the SOS for Administrative Rules is less than $5,000. The SOS recognizes that this is a small amount and does not expect that additional funding would be required to meet these costs. However, the 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 the office can sustain with its core budget. Therefore, the 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.

FISCAL IMPACT – State Government	FY 2024 (10 Mo.)	FY 2025	FY 2026
GENERAL REVENUE FUND			
Revenue Reduction - §143.022 – Business Exemption p. (3-4)	($2,263,751)	($2,163,156)	($2,158,848)
Revenue Reduction - §143.121 Beginning farmer subtraction p. (4-7)	($60,638 to $9,702,000)	($58,800 to $9,408,000)	($57,575 to $9,212,000)
Costs – DOR - §143.121 Form and Computer Upgrades p. (8)	($24,386)	$0	$0
ESTIMATED NET EFFECT ON GENERAL REVENUE	**($2,348,775 to $11,990,137)**	**($2,221,956 to $11,571,156)**	**($2,216,423 to $11,370,848)**

FISCAL IMPACT – Local Government	FY 2024 (10 Mo.)	FY 2025	FY 2026
	$0	**$0**	**$0**

FISCAL IMPACT – Small Business

Small agriculture businesses could be positively impacted by this proposal.

FISCAL DESCRIPTION

The proposed legislation modifies provisions relating to agriculture-related tax deductions.

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 - Budget and Planning

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