COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 3527S.02P
Bill No.: Perfected SS for SB 807
Subject: Taxation and Revenue - Income; Tax Credits; Corporations; Campaign Finance
Type: Original
Date: March 22, 2022

Bill Summary: This proposal modifies provisions relating to corporations.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2023	FY 2024	FY 2025
General Revenue	Could significantly exceed ($9,874,383)	Could significantly exceed ($26,225,148)	Could significantly exceed ($41,324,835)
Total Estimated Net Effect on General Revenue	**Could significantly exceed ($9,874,383)**	**Could significantly exceed ($26,225,148)**	**Could significantly exceed ($41,324,835)**

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2023	FY 2024	FY 2025
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 2023	FY 2024	FY 2025
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2023	FY 2024	FY 2025
General Revenue – DOR	5 FTE	5 FTE	5 FTE
General Revenue – DED	1 FTE	1 FTE	1 FTE
Total Estimated Net Effect on 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 2023	FY 2024	FY 2025
Local Government	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

Oversight was unable to receive some of the agency responses in a timely manner due to the short fiscal note request time. Oversight has presented this fiscal note on the best current information that we have or on prior year information regarding a similar bill. Upon the receipt of agency and local 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 34.195 – Report regarding State Contracts

In response to a similar proposal from this year (Perfected HB 1590), officials from the **Office of Administration (OA)** state this bill requires OA to file a report annually with the General Assembly about the number of contracts awarded to contractors who have been in business for less than 3 years. This will require FMDC to examine each of its awarded contractors to determine how long they have been in business and to track such information in order to create the report. FMDC estimates that this will take approximately 1 hour per awarded contract. FMDC awards approximately 500 contracts per year. FMDC assumes it will also need to update its bid/contract forms in order to gather necessary information from contractors and update its internal policies and procedures to sets standards about how this determination will be made. FMDC estimates that it will take approximately 200 hours of initial work to develop and implement these changes. Therefore, the estimate impact to staff time from this section is 700 hours at a rate of $36.70 totaling $25,690.

Oversight assumes OA will not hire additional staff to perform these functions and will be able to absorb these new reporting requirements with existing resources.

Officials from the **Department of Revenue (DOR)** note this section requires that the Office of Administration file an annual report with the General Assembly on the number of contracts issued to companies in business for less than 3 years. This section is not expected to have a fiscal impact the Department.

Officials from the **Office of Administration - Budget and Planning** assume this section would require the Office of Administration (OA) to file an annual report, starting no later than June 30, 2024, with the general assembly. The report shall include information on how many contracts, and the total dollar amount, that were awarded to businesses operating for less than three years versus those operating for three years or more.

B&P notes that this provision will not impact TSR or the calculation under Article X, Section 18(e).

Section 143.022 New Business Income Tax

Officials from the **Department of Revenue (DOR)** and the **Office of Administration - Budget and Planning (B&P)** note this provision in Section 143.022 would tax pass-through business income in a separate manner from other individual income for new businesses created after January 1, 2023. The Department notes that this would apply to S-corporations, Sole Proprietorships, Partnerships, and Limited Liability Companies (LLCs). Section 143.022 currently allows a subtraction from an individual's federal adjusted gross income of a percentage of the individual's business income. The percentage that may be subtracted is described in subsections 4-6. This provision would be amended to add subsections 7 and 8. Subsection 7 defines "new business income" as business income from a taxpayer that begins business operations in the state on or after January 1, 2023. Subsection 8 provides for a reduction in the new business income left after the subtraction in subsection 2. This allows for the first $100,000 in remaining income to be reduced 20% for each of the first three years the business is in operation.

Exempted Income

Year of Operation	Income Limit	% Exempt	$ Exempt
1	$100,000	20.0%	$20,000
2	$100,000	20.0%	$20,000
3	$100,000	20.0%	$20,000

This provision would create a new corporate business income tax structure for C-corporations created after January 1, 2023 in Section 143.071.

Section 143.071 currently imposes corporation income tax at a rate of 4%. It would be amended to add new subsections 4 and 5. Subsection 4 defines "eligible new corporation" (begins operation in the state on or after January 1, 2023) and subsection 5 imposes a tax on each "eligible new corporation." As described, there is a new tax rate of 3% on the first $100,000 of income. Anything over the first $100,000 is taxed at the 4% rate. In year four, the rate for all businesses is 4%.

Table 2: Income Thresholds for Taxation for Corporations

Years of Operation	Lower Income	Tax Rate	Higher Income	Tax Rate
1	$100,000	3.0%	$100,001	4.0%
2	$100,000	3.0%	$100,001	4.0%
3	$100,000	3.0%	$100,001	4.0%
4	all income			4.0%

Based on the 2017 Annual Business Survey (the most complete year available) published by the U.S. Census Bureau the following chart shows the number of firms by length of operations and their average annual revenue in Missouri.

Businesses 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

Using the above information and information published by the National Small Business Association the following chart shows the estimated number of firms for each formation type.

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
As of January 1, 2020 the corporate tax rate under Section 143.071 is 4.0%. Using the business information above, the Department was able to calculate an individual firm's income tax currently and what it would be under the provision. DOR found that most businesses would save about $1,000 for each of the first 3 years in operation. Shown is the estimated impact per firm.

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	$19,822	($1,000)
2	2,840	$25,574	$24,574	($1,000)
3	2,840	$25,574	$24,574	($1,000)
4	2,000	$40,521	$40,521	$0

To account for the number of business closures within the first five years of operation, the Department utilized the number of firms operating less than 2 years, between 2 and 3 years, and between 4 and 5 years. As the table shows below, reducing the corporate income taxes will result in a loss to general revenue of up to $9,070,000 annually by tax year 2025.

Corporate Income Tax
Loss by Tax Year

Tax Year	GR Loss
2023	($3,390,000)
2024	($6,230,000)
2025	($9,070,000)
2026	($9,070,000)
2027	($9,070,000)
2028	($9,070,000)

Based on historical revenue receipts, 50% of corporate income taxes are remitted during FY1 and 50% are remitted during FY2. Since this provision would begin at the beginning of a firm's tax year, the Department assumes the corporations will adjust their declarations payments during the first fiscal year. Therefore, this provision will reduce TSR and GR by approximately $1,695,000 in FY23. Once fully implemented in FY26, this provision will reduce TSR and GR by $9,070,000 million annually.

Corporate Income Tax
Loss by Fiscal Year

Fiscal Year	GR Loss
2023	($1,695,000)
2024	($4,810,000)
2025	($7,650,000)
2026	($9,070,000)
2027	($9,070,000)
2028	($9,070,000)
2029	($9,070,000)

Individual Income Tax
LLCs, S-Corporations, Sole Proprietorships, and Partnerships are all "pass-through" entities and owners of such firms report business income on their individual income tax form and not on a corporate income tax form. Per SB 509 & SB 153 reductions occur in the individual income tax rate based on growth in net general revenue. The individual income tax rate for FY 2022 is 5.3%. The individual income tax rates are shown below.

Additionally, Section 143.022, grants pass-through businesses an income exemption on a portion of their business income. Currently 15% of business income for pass-through business income is tax exempt. One more 5% increase is scheduled to occur pending SB 509 triggering. Under this provision, these newly created pass-through businesses would still be allowed to use this income exemption. The chart below shows when this reduction is scheduled to occur.

Based on current revenue forecasts and average revenue growth the following charts shows the forecasted individual income tax and business exemption rates.

Estimated Individual Income Tax Reductions

Tax Year	Top Rate	Pass-Through Exemption	Enacting Bill
2017	6.0%	0%	
2018	5.9%	5%	SB 509 (2014)
2019	5.4%	10%	SB 509 (2014) & HB 2540 (2018)
2020	5.4%	10%	
2021	5.4%	10%	
2022	5.3%	15%	SB 509 (2014)
2023	5.3%	15%	
2024	5.2%	20%	SB 509 (2014) and SB 153 (2021)
2025	5.1%	20%	SB 509 (2014)
2026	5.0%	20%	SB 509 (2014)
2027	4.9%	20%	SB 153 (2021)
2028	4.8%	20%	SB 153 (2021)

Based on all these changes that are scheduled to occur and the changes made by this provision, DOR would expect to see a reduction per firm of taxes owed of $1,020 to $1,060 per year for a business started in tax year 2023. Businesses starting in future years may face a different income tax structure due to rate reductions and income exemption increases (SB 509 changes) scheduled to occur. The below table shows the estimated impact for firms established in tax year 2023.

Pass-Through Income Tax Impacts for Businesses Started in Tax Year 2023*

Year of Operation	Number of Businesses	Current Estimated Taxes**	Proposed Estimated Taxes**	Difference in Taxes Owed
1	14,642	$23,451	$22,391	($1,060)
2	12,264	$26,597	$25,557	($1,040)
3	12,264	$26,086	$25,066	($1,020)
4	8,637	$40,521	$40,521	$0

*This is only the tax structure for businesses started in 2023.
**The estimates for current and proposed taxes accounts for the top rate reductions and business income exemptions under SB 509 (2014) and SB 153 (2021).

To account for the number of business closures within the first three years of operation, DOR utilized the number of firms operating less than 2 years and those between 2 and 3 years. DOR estimates that in total, this provision may reduce individual income taxes by $37,603,200 annually by tax year 2028. The table shows the estimated impact by tax year.

Table 10: Individual Income Loss by Tax Year

Tax Year	GR Loss
2023	($15,520,520)
2024	($27,982,240)
2025	($39,953,400)
2026	($39,170,000)
2027	($38,386,600)
2028	($37,603,200)

Since this provision begins at a firm's tax year, individuals will adjust their withholdings and declarations during the first fiscal year. Historically, 42% of individual income taxes are remitted during FY1 and 58% are remitted during in FY2. Therefore, this provision will reduce TSR and GR by $6,518,618 million in FY23. Once fully implemented in FY29, this provision will reduce TSR and GR by $37,603,200 million annually. The estimated impact by fiscal year.

Individual Income Loss by Fiscal Year

Fiscal Year	GR Loss
2023	($6,518,618)
2024	($20,754,442)
2025	($33,010,127)
2026	($39,624,372)
2027	($38,840,972)
2028	($38,057,572)
2029	($37,603,200)

Summary
The total impact to the state:

Table 12: Summary of GR Impact

Fiscal Year	GR Loss
2023	($8,213,618)
2024	($25,564,442)
2025	($40,660,127)
2026	($48,694,372)
2027	($47,910,972)
2028	($47,127,572)
2029	($46,673,200)

DOR Administrative Impact
DOR notes this provision would require an entire separate regime to impose a separate rate of taxes. This would involve programming changes and possible new FTEs. This provision requires the Department 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.

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

The Department 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. Additionally DOR will need the following FTE if the amount of correspondence justifies the FTE.

1 FTE Revenue Processing Technician for every 14,700 errors created
1 FTE Revenue Processing Technician for every 5,700 pieces of correspondence generated

For the purposes of this fiscal note, **Oversight** will report the three (3) FTE Auditors and (2) FTE technicians required by the Missouri Department of Revenue. In addition, Oversight will show the cost of new computer program modifications as estimated by DOR. Oversight notes DOR based the estimate on other major upgrades DOR has done to the income tax system and will continue to research and update when needed.

For purposes of this fiscal note, **Oversight** will report the impact to GR as a result of both the corporate and individual income tax changes as reported by B&P and DOR, summarized in the table below:

Fiscal Year	GR Loss Individual Income Tax	GR Loss Corporate Income Tax	Total GR Loss
2023	($6,518,618)	($1,695,000)	($8,213,618)
2024	($20,754,442)	($4,810,000)	($25,564,442)
2025	($33,010,127)	($7,650,000)	($40,660,127)
2026	($39,624,372)	($9,070,000)	($48,694,372)
2027	($38,840,972)	($9,070,000)	($47,910,972)
2028	($38,057,572)	($9,070,000)	($47,127,572)
2029	($37,603,200)	($9,070,000)	($46,673,200)

Section 143.081 Tax Credit for S-Corporation

Officials from the **Office of Administration - Budget and Planning (B&P)** state this provision would grant a tax credit for S-Corporation shareholders for income earned outside of Missouri, if the income earned out of state is not subject to income taxes in the state in which it was earned. The tax credit shall be equal to the shareholders proportion of Missouri income tax owed on such out of state S-Corporation income. This credit would begin on August 28, 2022. Since this is before the end of the 2022 tax year, B&P assumes that the credit would be available for taxpayers filing their annual 2022 tax returns.

B&P notes that shareholders are already allowed a resident income tax credit if income earned out of state is subject to another state’s income tax. B&P further notes that this would essentially eliminate the Missouri tax on all out of state income earned by any S-Corporation, if that income is not subject to any other state’s income tax.

Based on information provided by DOR, for tax year 2018 fewer than 1% of S-Corporations claimed out-of-state income. However, B&P was unable to determine how much of such S-

Corporations income was derived from out-state-sources and how much of that income came from other states that do not levy an income tax. Therefore, B&P estimates that this provision will have an unknown negative impact on TSR and GR beginning in FY23.

Officials from the **Department of Revenue (DOR)** state this provision would allow a resident shareholder in an S-Corp to be eligible for a credit issued pursuant to this section in an amount equal to the shareholder's pro rata share of any income tax imposed pursuant to chapter 143 on income derived from sources in another state of the United States, or a political subdivision thereof, or the District of Columbia, and which is subject to tax pursuant to chapter 143 but is not subject to tax in such other jurisdiction.

S-Corps are required to file a MO-1120S (S-Corporation Income Tax Return) with the Department of Revenue annually. One of the questions on the form requires S-Corps to disclosure if any of the income they receive is from sources other than those located in Missouri. Of the 87,907 S-Corps that completed the 2018 MO-1120S form, less than 1% indicated income outside Missouri.

<u>The Department is unable to estimate the amount of the income that was reported as out of the state.</u> Additionally, the Department cannot determine if any of that income is from jurisdictions that do not tax. The Department assumes an unknown impact that could exceed $250,000 annually.

No administrative fiscal impact is expected to the Department from this provision.

Oversight is unable to estimate the amount of out of state income reported by S-Corporations. Therefore, **Oversight** will show a negative unknown impact that could exceed $250,000 annually.

<u>Section 143.121 – Medical Marijuana Business Expense Deduction</u>

Officials from the **Office of Administration - Budget and Planning (B&P)** state this provision would allow medical marijuana related business to deduct business expenses from their Missouri adjusted gross income. B&P notes that this proposal would begin August 28, 2022 which is during tax year 2022. Therefore, B&P assumes that this deduction would become available for taxpayers for tax year 2022. B&P notes that tax year 2022 returns would not be filed until April 2023. Therefore, B&P estimates that this proposal could reduce GR beginning in FY23.

B&P notes that typically businesses are allowed to deduct certain expenses from their federal adjusted gross income (FAGI). Those deductions would then flow through to the business's Missouri adjusted gross income (MAGI) allowing for an implicit deduction from Missouri's income tax. However, because marijuana is a controlled substance at the federal level, marijuana related businesses are not allowed to deduct their business expenses on their federal taxes. This would allow such businesses to receive the business expense deduction at the state level.

B&P was unable to obtain enough revenue, cost, or profit margin data for medical marijuana related businesses to estimate the GR impact from this proposal. Therefore, B&P estimates that this proposal will reduce TSR and GR by an unknown, but significant, amount beginning with FY23.

Officials from the **Department of Revenue (DOR)** note this provision would allow medical marijuana businesses a subtraction from the federal adjusted gross income the amount that would have been allowed from the computation of the taxpayer's federal taxable income if the income were not disallowed solely from them being a medical marijuana business. Under federal law marijuana is a controlled substance and businesses selling it are not allowed some deductions that other businesses are entitled to. Since marijuana is allowed to be sold in Missouri, this would allow them to adjust their federal adjusted gross income before calculating their Missouri adjusted gross income.

This would require the Department to make an independent interpretation of federal law on what would or would not be an allowable federal deduction. The Department is unable to calculate the amount of income and deductions that these businesses could possibly be allowed to deduct under this proposal. The Department assume this could result in an Unknown that could be significant negative fiscal impact to general revenue and total state revenue.

This bill would become effective August 28, 2022, and with no specific start date it would allow people to start filing for this immediately. Therefore, they show the impact starting in FY 2023.

This would require a change to the Forms MO-A and the MO-1120. The Form MO-A has a selection of check boxes for a set of "other" subtractions, so a new line would not necessarily be required. The Form MO-1120 does not currently have this checkbox option, so it would either require a new line or a reformatting of the subtractions in Part 2.

Additionally, this would require us to update our individual income tax computer system. These changes are estimated to cost $11,579.

The Department notes if may need the following FTE if the volume of returns justify the FTE.

- 1 FTE Revenue Processing Technician for every 14,700 errors created
- 1 FTE Revenue Processing Technician for every 5,700 pieces of correspondence generated
- 1 temporary employee for new line item

Oversight assumes the Department of Revenue is provided with core funding to handle a certain amount of activity each year. Oversight assumes DOR could absorb the costs for computer upgrades related to this proposal. Given the few number of potential qualifiers of this deduction, Oversight assumes DOR can absorb the administrative impact of this proposal.

Officials from the **Department of Health and Senior Services** state as of January 7, 2022, the number of medical marijuana facilities approved to operate in Missouri were as follows:

Testing Labs – 8
Cultivation – 41
Manufacturing – 58
Dispensary – 181
Transportation – 20

Oversight notes that it does not currently have the resources and/or access to state tax data to produce an independent estimate to the GR impact from this proposal. **Oversight** notes that the bill becomes effective August 28, 2022. Therefore, **Oversight** will show a reduction to TSR and GR by an unknown, but possibly significant, amount beginning with FY23.

In response to a previous version (SB 807), officials from the **Department of Health and Senior Services** assume the proposal will have no fiscal impact on their organization. **Oversight** does not have any information to the contrary. Therefore, Oversight will reflect a zero impact in the fiscal note for this organization.

Section 143.436 "SALT Parity Act"

Officials from the **Office of Administration - Budget and Planning (B&P)** state this provision would allow pass-through businesses (LLCs, partnerships, sole proprietorships, and S-corporations) to file their Missouri income tax at the entity level, rather than the individual level starting with tax year 2023. B&P notes that the election to complete an entity level tax return shall be made on a voluntary year-by-year basis.

B&P notes that the purpose of this bill is to allow businesses to fully deduct their state and local taxes (SALT) at the federal level, while minimizing the impact to states that pass this or similar language. Under the Tax Cut and Jobs Act (TCJA, 2017) individuals cannot claim a SALT deduction greater than $10,000, while businesses can claim their full SALT expenses. This has created a significant federal tax increase for pass-through businesses whose SALT deduction is greater than the $10,000 cap x the number of pass-through members. For example:

- Business A consists of 4 members and has a total SALT liability of $20,000
    - Business A would not be impacted by the individual SALT limitation as the combined SALT limit for the 4 members would be $40,000 (4 members x $10,000 per member cap).
    - Business A would likely not choose to file taxes at the entity level under this provision.
- Business B consists of 4 members and has a total SALT liability of $80,000
    - Business B would be impacted by the individual SALT limitations as the combined SALT limit of $40,000 (4 members x $10,000 per member cap) is less than the $80,000 entity SALT liability.
    - Business B would likely chose to file taxes at the entity level under this provision.

B&P further notes that as of the creation of this fiscal note, the IRS is allowing this particular SALT cap work around. If the IRS disallows this work around, B&P assumes that entities would no longer choose to file a Missouri return at the entity level.

Currently, each member of a pass-through business must file their own Missouri income tax return showing their portion of business income and deductions. The individual is then responsible for their portion of the Missouri income tax. Individuals are also granted a tax credit for taxes paid in other states, for businesses that operate in multiple states.

Under this provision, the entity itself could elect to file a Missouri income tax return. The business is to include the same income, deductions, and credits granted at the federal level. If the calculations result in a net loss, the loss is not refundable, but the business may carry the loss forward until fully used. B&P notes that individuals are not granted a similar net operating loss credit. Therefore, this provision may have an unknown impact on TSR and GR.

B&P notes that businesses would be required to use the corporate income allocation method, as opposed to the current individual allocation method, when determining the amount of income to allocate to Missouri and other states. Therefore, this provision may have an unknown positive or negative impact to TSR and GR depending on the composition of a business's income.

In exchange for filing at the entity level, the entity must calculate their tax due using the highest individual income tax under Section 143.011 in a given tax year. Currently individuals calculate their tax due using the graduated brackets and rates under Section 143.011. This may have minimal impact to TSR and GR.

This provision would allow non-Missouri residents, with no other Missouri source income other than the income now reflected at the entity level, to not file a Missouri income tax return.

This provision would further grant Missouri residents, and non-residents with other Missouri source income, a 95% tax credit for their pro-rata share of the taxes paid to other states at the entity level. B&P notes that this provision would allow a 100% credit for S-corporations. This credit would only be granted for the taxes paid at the entity level to other states. This may have an unknown impact to TSR and GR. B&P notes that the impact would depend on the impacts created by changing how business income is allocated between states. The credit is non-refundable, but may be carried forward until fully used.

B&P does not know how many businesses would elect to pay Missouri taxes at the entity level. Further, B&P does not know the income composition of such businesses or the current tax liability of members and thus cannot estimate how this provision may impact their Missouri tax liability. Therefore, B&P estimates that this provision may have an unknown positive or negative impact on TSR and GR beginning with FY24.

Officials from the **Department of Revenue (DOR)** state under the Tax Cut and Jobs Act (2017) the federal government limited the amount of state and local taxes (SALT) an individual could deduct for federal income tax purposes to no more than $10,000 ($5,000 for those married filed separately) annually. However, there were no changes to the limitations on the amount of a deduction connected with a business entity directly.

Capping the amount of the SALT deduction at the federal level resulted in fewer taxpayers being able to reduce their federal tax liability.

Under current law, a pass-through entity's (S Corporations or Partnership) shareholders pay income tax on the shareholder's pro rata share of the entity's income attributable to Missouri. They file their share on their individual income tax return rather than the business entity filing a corporate income tax return. Therefore, each member reports his or her proportion of the entity's whole income. Therefore, each of the individual members is subject to the $10,000 SALT limit on their return.

This provision creates the SALT Parity Act. The purpose of the act is to help companies increase the amount of itemized deductions they can claim at the federal level by finding a work-around of the $10,000 SALT deduction. Increasing their itemized amount would result in a savings to taxpayers, as their federal tax liability would decrease.

A business entity is not bound by the $10,000 limit. Therefore, a plan was created in several states and appears to be allowed by the federal government that would allow the business entity to report the group's income and pay the taxes of the group as a whole. The business entity then receives the greater itemized deduction on their federal return and lowers their overall tax liability. This results in a savings to the business entities.

This provision is setting up this work around at the state level for Missouri businesses. This provision in Section 143.436.3 & 143.4360.4 would allow partnerships and S Corporations to pay as a whole. The partnership or S Corp would report income for the whole business and file a return on behalf of the entire group. For tax years beginning on or after January 1, 2023, this act would allow the pass-through business entity to elect to pay a company tax. The tax is to equal the sum of each member's income and loss items, as described in federal law, reduced by a deduction allowed for qualified business income, as described in federal law, and modified by current provisions of state law relating to the taxation of pass-through entities, with such sum multiplied by the highest rate of tax in effect for the state personal income tax rate.

Per this provision, they would be required to use the highest individual income tax rate for the tax rate. That rate is currently 5.3% for TY 2022. Currently, if members of the business entity pay taxes, the amount paid depends on their income and which tax bracket they are assessed at. Having these business entities pay the state the highest individual income tax rate could potentially result in an increase in revenue to the state as opposed to each member filing separately.

Upon filing the business entity tax return, the business entity notifies the Department of its election to file as a group and provides a report to the Department of the proportional share of income earned and tax paid of each member. The individual members of the business entity are then required to file an individual income tax return. They must report the amount of the pro rata share that was paid by the business entity. They are then allowed a credit against the tax already paid by the business entity.

The credit is equal to their pro rata share of the tax paid. This provision states these credits are not refundable but can be carried over until fully taken. The lack of refundability of the credits could result in some members not being able to use their credits. If credits are never redeemed this results in revenue to the state.

This provision in Section 143.436.11 requires these business entities to annually elect whether or not to participate in this business entity tax program. This program is strictly voluntary. Due to the voluntary nature of this program, the Department is not able to determine how many potential S Corps or partnerships would chose to participate each year.

The Department assumes that business entities would chose to participate based on what is best for the majority of its members. While a business entity may choose what is best for the majority of its members, some members may not see a benefit under this program. Individual income tax returns are specific to each taxpayer's life situation. Two people with the same job and same income may have very different life situations that can impact the amount of tax liability they will have. One may be married with kids while the other may be single with no kids but an illness that requires extensive medical payments. Their final tax liability may be different.

Is it possible that due to an individual's life situation they end up owing less in taxes to the State than they otherwise would have if their business reported under current law? It is possible. It is also possible they could owe more. Depending on which happened, additional or less revenue to the state is possible.

The Department notes it is unable to estimate the actual fiscal impact of this provision. The Department cannot predict the number of business entities that would chose to participate in this voluntary program. Nor is the department able to predict how many of the individual taxpaying business entity members would benefit or be hurt by this provision. The Department notes that business entity members would benefit from the increased federal deduction and receive a savings on their federal return. However, based on the taxes paid by the business entity as a whole and the credits provided the members, this provision would not result in more than a minimal impact to the state.

The Department notes this provision would ease an administrative burden on the Department. Under current law, in order to audit, the Department spends a lot of time trying to identify all the members of a business entity to ensure all the tax is paid. With the business entities filing the taxes and reporting the number of partners and pro rata share of the income, this would allow the Department to more easily audit these businesses, saving time and resources. This provision with the previous partnership audit reporting laws that passed in 2020 will ease some of the time consuming tracking of these business entities. The amount of the impact can't be determined due to the voluntary nature of the program.

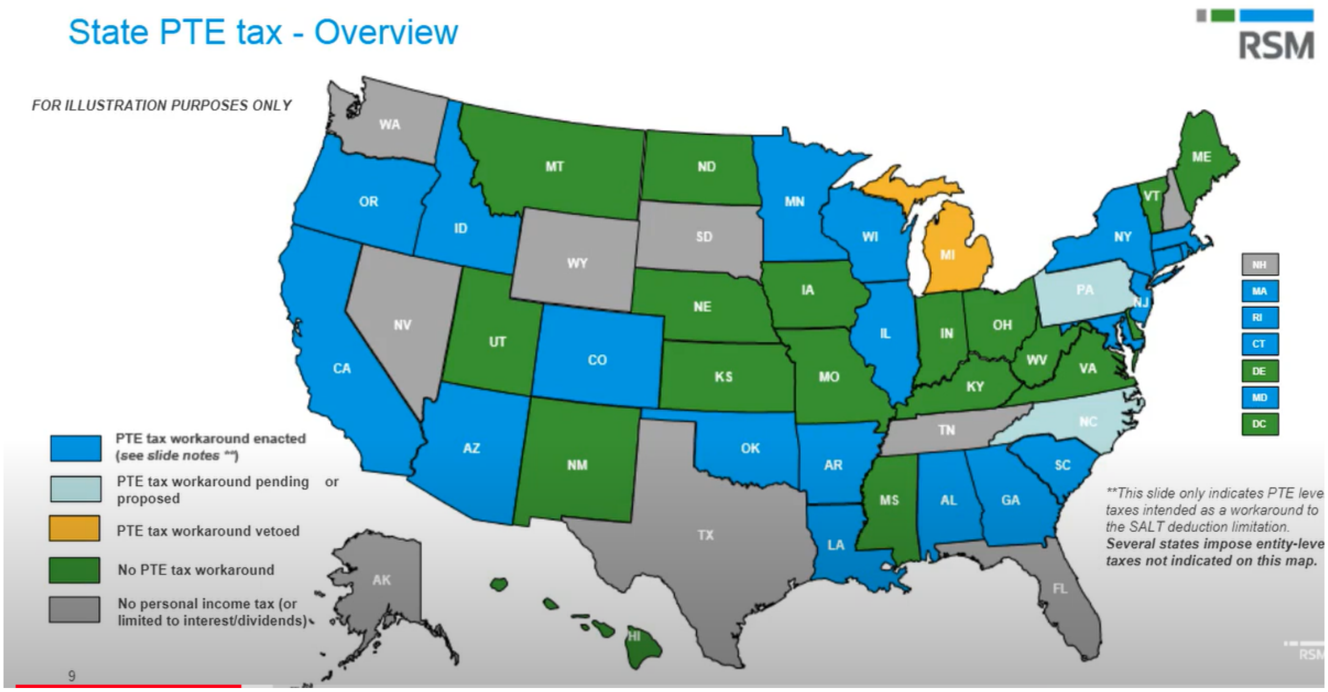
The Department notes this will require making changes to the existing tax reporting forms and potentially the creation of a new form for identifying the business entity members and their pro rata share. These changes are estimated to cost $5,000. Additional programming and other website updates would result in $3,596 in costs.

Oversight assumes the Department of Revenue is provided with core funding to handle a certain amount of activity each year. Oversight assumes DOR could absorb the form and programming (administrative) costs related to this provision. If multiple bills pass which require additional staffing and duties at substantial costs, DOR could request funding through the appropriation process. Officials from the DOR assume the provision will have minimal fiscal impact on their organization.

Oversight notes that **DOR** and **B&P** both note the deductions for purpose of the state and local taxes (SALT) paid by pass-through business owners are currently capped at $10,000. Conversely, C corporations are allowed to fully deduct these same expenses. In states that tax pass-through firms at the owner level, the disparate treatment puts their firms at a significant disadvantage compared to C corporations. As such, restoring the federal SALT deduction in its entirety for pass-through entities has been a key priority for S-CORP and the Main Street Employers coalition since the cap was implemented back in 2017.

Oversight notes, that according to the taxpolicycenter.org, a joint project from the Urban Institute and the Brookings Institution, in 2017, 16 percent of tax filers with income between $20,000 and $50,000, 76 percent of tax filers with income between $100,000 and $200,000, and over 90 percent of tax filers with income above $200,000 claimed SALT.

Oversight notes since 2018, the Main Street Employers coalition has led advocacy efforts to restore the State and Local Tax (SALT) deduction for pass-through businesses. More than a half dozen states have enacted various versions of such a legislation to date and, following the 2020 Treasury Department announcement, IRS Notice 2020-75 (11/2020), validating this legislative approach, SALT Parity measures are being actively considered in more than a dozen states this year.



https://news.bloombergtax.com/tax-insights-and-commentary/salt-cap-workaround-pass-through-entity-tax-update-part-ii

Oversight notes that under this provision, a small business may elect to pay tax at the entity level, and a corresponding credit is allowed at the partner, member, or shareholder level. There are four main categories of businesses, which would qualify for such a deduction as shown below:

a) General Partnerships
b) Limited Partnerships
c) Limited Liability Companies
d) Sub-Chapter S Corporations

Additionally, there are no restrictions as to Multi-tier Partnerships or Trusts that are entity partner members.

Oversight notes that officials from the DOR and SOS added, via additional e-mails, that there are currently at least 81,000 S-Corporations in Missouri. The Department of Revenue is not able to discern how many partnerships are currently in Missouri. Officials from the SOS note that a partnership can exist and function as a business without any kind of document setting out the rights or responsibilities of the partners. These partnerships function similarly to a sole proprietorship, but have two or more owners (partners). The only partnerships which have to register with the SOS are those which intend to limit the liability of the individual partners or the partner company, and in this regard, function similarly to a corporation. Therefore, neither DOR nor SOS can estimate the collective number of partnerships which operate in Missouri at any given time, as they are not all required to register.

Oversight notes that by paying tax at the entity level, members of the PTE are deducting expenses and taxes incurred by the trade or business (i.e., an above-the-line deduction) versus a conventional below-the-line deduction at an individual level that would be subject to the SALT limitation of $10,000. Moreover, according to estimates from the U.S. Congress' Joint Committee on Taxation, less than 15% of taxpayers currently qualify to itemize their deductible amounts while filing taxes with average AGI of $60,981 and an average SALT amount of $9,958.

As provided in the provision, companies file their income tax at the individual level while using the 95% credit for filing at the entity level as a deduction. For the purpose of this provision, **Oversight** will assume that the company election process will happen throughout FY 2023 due to various companies' filing tax schedules. (I.e. some filing monthly, quarterly, annually, etc.)

For information purpose, **Oversight** will show the various impact of the provision below:

Table 1

Proposed - *assuming $200,000 deductible without SALT cap			
Entity Level	ABC LLP - 2 Members 50/50 Partners		
Net Income	800,000		
Tax laibility paid	32,000		
Member level	A - 50%		B-50%
Net Income	$ 400,000.00		$ 400,000.00
Tax	$ 21,200.00		$ 21,200.00
Tax Credit at 95%	($32,000/2)*.95		($32,000/2)*.95
Tax credit amount awarded	$ 15,200.00		$ 15,200.00
Tax liability amount at members level	$ 6,000.00		$ 6,000.00
Total tax paid	$ 22,000.00		$ 22,000.00
			$ 44,000.00

Oversight notes the example in Table 1 shows how the 95% tax credits would work against the personal income taxes at the individual member level from the current law.

Table 2

Current Law			
Entity Level	ABC LLP - 2 Members 50/50 Partners		
Net Income	1,000,000		
Tax laibility paid	0		
Member level	A - 50%		B-50%
Net Income (entity + other income)	$ 600,000.00		$ 600,000.00
Tax	$ 31,800.00		$ 31,800.00
Tax Credit at 95%			
Tax credit amount awarded			
Tax liability amount at members level			
Total tax paid to the State	$ 31,800.00		$ 31,800.00
			$ 63,600.00

Oversight notes in Table 2, the current law provides lesser tax deductions beyond SALT allowable deductions. However, Table 3 also shows that due to the personal income of each member within the partnership, the overall collected tax in Missouri would not be lesser or higher, but minimally higher or lesser depending on the individual company and each member's personal tax consequence.

Table 3.

Entity Level	ABC LLP - 2 Members 50/50 Partners		
Net Income	800,000		
Tax laibility paid	32,000		
Member level	A - 50%		B-50%
Net Income (entity + other income)	$ 600,000.00		$ 600,000.00
Tax	$ 31,800.00		$ 31,800.00
Tax Credit at 95%	($32,000/2)*.95		($32,000/2)*.95
Tax credit amount awarded	$ 15,200.00		$ 15,200.00
Tax liability amount at members level	$ 16,600.00		$ 16,600.00
	(31,800-15,200)		
Total tax paid	$ 32,600.00		$ 32,600.00
	partner 1+ partner 2 tax totals		**$ 65,200.00**

Oversight is not able to discern the level of gain or loss to general revenue in any given year because there is currently no data showing the amount of individual income levels or tax rate for each affected company specified within the provision. (I.e. LLP, LP, S-Corp. etc.)

Oversight notes the provision shall be effective January 1, 2023. The taxpayers will not be filing their 2023 income taxes until January 1, 2024 (FY 2024). Therefore, Oversight will note a minimum Unknown positive to Unknown negative impact beginning in FY 2024 in the fiscal note.

Oversight notes that while the Tax Cuts and Jobs Act placed a $10,000 cap on the SALT deduction, it's only temporary. The cap applies to taxable years 2018 through 2025. After tax year 2025, the cap will end, and taxpayers will once again be able to deduct 100 percent of their eligible state and local taxes, unless other tax code changes are passed before then.

In response to a similar proposal (SB #931), officials from the **Joint Committee on Administrative Rules (JCAR)** assume this provision 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.

In response to a similar proposal (SB 931), 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.

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.

Section 620.3800 – Office of Entrepreneurship

Officials from the **Department of Revenue** assume this provision will not fiscally impact the Department.

Officials from the **Office of Administration - Budget and Planning** note this section would create the "Office of Entrepreneurship" under DED. The office shall promote policies and initiatives to support entrepreneurship within Missouri. In addition, the Office of Entrepreneurship and OA shall jointly make recommendations on improving access and resources for businesses in operation for less than three years.

In response to a similar proposal (HCS for HB 1590), officials from the **Department of Economic Development (DED)** noted that DED is responsible for administering the “Office of Entrepreneurship” and shall employ an individual to promote policies and initiatives to support the growth of entrepreneurship in the state. The Office of Entrepreneurship is also responsible for preparing a report for the general assembly making recommendations on improving access and resources for new Missouri businesses that have been in operation for less than three years. DED will need 1.0 FTE to administer the Office of Entrepreneurship.

Oversight notes the **Department of Economic Development (DED)** has not responded to our request for fiscal impact regarding this perfected version when this fiscal note needed to be completed. Oversight assumes the amendment will not change DED’s response.

FISCAL IMPACT – State Government	FY 2023 (10 Mo.)	FY 2024	FY 2025
GENERAL REVENUE			
Revenue Reduction – §143.022 - Reduction in income tax owed by new businesses p. (3-10)	($8,213,618)	($25,564,442)	($40,660,127)
Costs - §143.022 – DOR new computer tracking p. (9-10)	($1,000,000)	$0	$0
Costs - §143.022 – DOR forms & Website Changes p. (9-10)	($14,772)	$0	$0
Costs – §143.022 - DOR p. (9-10)			
Personal Service	($161,618)	($195,881)	($197,840)
Fringe Benefits	($111,132)	($134,063)	($134,775)
Exp. & Equip.	($48,556)	($2,455)	($2,516)
Total Costs – DOR	($321,306)	($332,399)	($335,131)
FTE Changes DOR	5 FTE	5 FTE	5 FTE
Revenue Loss - §143.081 Tax Credit for S-Corporation p. (10-11)	(Unknown – could exceed $250,000)	(Unknown – could exceed $250,000)	(Unknown – could exceed $250,000)
Revenue Loss – §143.121 – Income Tax Deduction For Medical Marijuana Businesses p. (11-13)	(Unknown, possibly significant)	(Unknown, possibly significant)	(Unknown, possibly significant)
Revenue Loss or Gain - §143.436 SALT Parity Act: Entity And Individual Tax Liability Paid p. (13-21)	$0	Minimum Unknown to Minimum (Unknown)	Minimum Unknown to Minimum (Unknown)
Costs – §620.3800 DED p. (21-22)			
Personal Service	($36,305)	($44,437)	($45,326)
Fringe Benefits	($24,500)	($29,692)	($29,990)
Exp. & Equip.	($13,882)	($4,178)	($4,261)
Total Costs – DED	($74,687)	($78,307)	($79,577)
FTE Changes DED	1 FTE	1 FTE	1 FTE

ESTIMATED NET EFFECT ON GENERAL REVENUE	**Could significantly exceed ($9,874,383)**	**Could significantly exceed ($26,225,148)**	**Could significantly exceed ($41,324,835)**
ESTIMATED NET FTE CHANGE ON GENERAL REVEUNE	**6 FTE**	**6 FTE**	**6 FTE**

FISCAL IMPACT – Local Government	FY 2023 (10 Mo.)	FY 2024	FY 2025
	$0	**$0**	**$0**

FISCAL IMPACT – Small Business

Section 143.022 - This provision could impact any small business that would qualify for the modified income tax schedule created under this proposed legislation.

Section 143.121 - This provision could positively impact any small business conducting business under Article XIV of the Missouri Constitution (Medical Marijuana) as these small businesses could claim a tax deduction reducing or eliminating their tax liability.

FISCAL DESCRIPTION

The proposed legislation modifies provisions relating to corporations.

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
Office of Administration
Office of the Secretary of State
Joint Committee on Administrative Rules
Department of Economic Development

Julie Morff
Director
March 22, 2022

Ross Strope
Assistant Director
March 22, 2022

KLP:LR:OD