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House Approved Tax Schemes Would Damage State Services, Disproportionately Benefit Highest Income Missourians

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The Missouri House approved two bills this week that would require sharp cuts to state services, undermining Missouri's economy by starving it of the resources it needs to offer quality education from preschool to college, a state of the art infrastructure, and safe, healthy, and stable communities.

Both of the bills would:

1. Severely undermine Missouri's ability to invest in education, public safety and infrastructure by reducing state general revenue. The bills would require between $700 million and $1.2 billion in cuts to Missouri's budget per year when fully implemented.[1]

2. Prevent K-12 education services from being fully funded, and other services from catching up to pre-recession levels, despite so-called "triggers."

3. Disproportionately benefit Missourians with the highest incomes, with the largest benefit reaching Missourians with incomes averaging more than $1 million.

4. Fail to create jobs.

Summary & Impact on General Revenue

House Bill 1253 and House Bill 1295 each contain a selection of the same problematic features that were part of last year's House Bill 253. The legislature sustained the Governor's veto of that bill due to the negative impact the bill would have had on Missourians.

House Bill 1253

HB 1253 would reduce state revenue by more than $700 million when fully implemented, an amount **more than double** what Missouri spends in general revenue dollars for community public health services *and* services for seniors, including home delivered and congregate meals, funding for Area Agencies on Aging, and services related to Alzheimer's.[2]

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[1] The official Fiscal Notes for the bills estimate a cost of $347 million for HB 1253 and $703 million for HB 1295; however, Missouri Budget Project's (MBP) analysis indicates that the **fiscal notes significantly understate the full cost of the proposals.** MBP estimates the fully implemented impact of the proposals to be much higher – $700 million for HB 1253 and $1.2 billion for HB 1295. The main distinctions between the MBP analysis and the fiscal notes appear to be: MBP utilizes calendar year 2013 individual income tax data as a base, while the fiscal notes use calendar year 2012; MBP utilizes IRS data to determine the impact of tax changes on business income, which begins with a larger base of what is considered business income as compared to the data sources relied on in the fiscal notes; and MBP incorporates inflationary growth as the tax reductions are phased in over a number of years, while the fiscal notes do not consider inflationary growth.

[2] Based on Fiscal Year 2014 general revenue funding of the Missouri Department of Health & Senior Services, which was approved at $277.7 million.

In what has become known as the "tax cut for lobbyists," House Bill 1253 would create a business income deduction of 50 percent for businesses that file their state taxes through the individual income tax structure, including LLCs (effectively exempting one-half of business income from tax). In addition, the bill would cut the corporate income tax rate in half from 6.25 percent to 3.125 percent. Finally, the bill includes a proportional reduction to the financial institutions (bank) tax.

This additional cut to the Financial Institutions (Bank) Tax would most significantly impact municipalities, as 98 percent of the revenue derived from it is distributed to local governments. In fiscal year 2012, Missouri collected $17.8 million from this tax, and $17.5 million was distributed to localities.[3] A cut of 50 percent to the financial institutions tax will directly result in $8.7 million less funding for local governments.[4]

House Bill 1295

HB 1295 would reduce state revenue by $1.2 billion when fully implemented – equivalent to one-third of state funding for local K-12 school districts, *or* more than Missouri spends on mental health, public safety and corrections each year.

Like HB 1253, House Bill 1295 also includes the "tax cut for lobbyists," described above. In addition, the bill would cut the top rate of individual income tax from 6 percent to 5.3 percent over a period of years. However, as discussed further below, most Missourians would benefit little from the tax cut, though cuts to services would impact all Missourians. The bill does not cut the corporate tax rate.

Missouri Will Never Be Able to Catch Up with Foundation Formula or Other Needs

The cuts required by the bills would reduce state revenues at a time when Missouri's critical public services are still recovering from the economic crises of the last decade. In particular:

- State funding for local K-12 school districts is already more than $600 million below the state's own funding formula.[5]
- Missouri's public higher education institutions received $93 million <u>less</u> in state general revenue funding this year than they did in state Fiscal Year 2010 (FY 2010). When adjusted for inflation, Missouri's public colleges received <u>$300 million less in state support than they did in FY 2001</u>.[6]
- Mental health services for children and adults with severe mental illness or developmental disabilities have also been cut significantly. During the economic crises over the last decade, state-funded mental health safety net services were cut by $18.7 million between FY 2003 and FY 2006, and again by $17 million between FY 2010 and FY 2013.[7] In addition, a shortage of hospital beds for acute psychiatric care due to funding reductions is impacting local law enforcement agencies, which often have to travel great distances to transport individuals to an open bed.[8]

Tax reductions of <u>any size</u> at this time of recovery will likely just result in further spending cuts and compound the struggles Missouri already faces. Further, faced with an array of unmet needs, tax reductions will likely mean that Missouri will never be able to catch up and fully fund its schools.

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[3] Fiscal Note for House Bill 1253

[4] Ibid.

[5] Estimate from the Missouri Department of Elementary & Secondary Education

[6] FY 2014 state general revenue funding for community colleges & 4-year institutions combined is $866 million; in FY 2011 the combined funding level was $959 million; in FY 2001; the combined funding level was $914 million – the equivalent of $1.2 billion when adjusted for inflation to today's dollars

[7] Missouri Coalition of Community Mental Health Centers

[8] Ibid.

“Triggers” Do Not Provide Security

Both House-approved bills have so-called “triggers,” or requirements that state revenue grow by select amounts in order for tax cuts to be implemented. However, these “triggers” are essentially meaningless and will not protect any sector from cuts.

HB 1253 contains a provision that requires the *combination* of corporate tax revenues and individual income tax revenues collected in Missouri to be equal to or greater than the amount of revenue received in FY 2012 from these two taxes. However, **tying a tax cut “trigger” to revenue levels received in FY 2012 won’t allow Missouri to keep pace with inflation**, let alone meet the funding requirements in the K-12 school funding formula, or restore mental health or higher education funding to previous levels.

HB 1295 contains a similar trigger provision, except its “trigger” requires $100 million in net growth of state general revenue compared to the highest level of revenue attained in any of the three previous fiscal years in order to implement the business income deduction. The bill also requires $150 million in growth of state general revenue compared to the highest level of revenue attained in any of the previous three fiscal years in order to implement the cut to the individual income tax rate.

Under HB 1295, 60 percent of the $150 million growth in revenue is “earmarked” for specific funding areas, with 40 percent of the growth dedicated to K-12 education and 20 percent dedicated to higher education.

However, the growth required in HB 1295 falls short of inflation, let alone allowing state services to recover to their levels prior to cuts being implemented. Further, in context, dedicating 40 percent of the $150 million growth factor for K-12 education would result in an increase for K-12 funding of just $60 million per year. In other words, at that rate, it would take 10 years for Missouri to reach today’s state mandated funding requirements for local schools, not accounting for inflation.

There is no “trigger” that would allow Missouri to adequately restore its funding commitments for education, health and mental health, public safety and infrastructure. The triggers are simply an illusion of protection.

Measures are Skewed to Benefit Very Wealthy Missourians

As shown in the accompanying table, components of the bills like the business income deduction and the reduction in the top rate of individual income tax are skewed to benefit the wealthiest Missourians. The income quintile impact serves only as an example of the impact that the bill components would have. As shown, each component – whether reducing the top rate of income tax or giving businesses a 50 percent tax cut – is skewed such that the benefit falls to Missourians with the highest incomes. As a result, while Missourians with average incomes exceeding $1 million per year could take a nice European vacation as a result of the cut, middle income Missourians could purchase a cup of coffee or a fast food meal.

Although some middle income families may get minor tax reductions from the bills, depending on the final version of the bill(s), any tax savings would quickly be spent on increased costs for basic services. For example, since its tax cuts took effect two years ago, at least 65 counties in Kansas have increased local property tax or other levies in order to avoid eliminating vital services. Moreover, despite a $300 million state sales tax increase, Kansas’ public colleges and universities have significantly increased tuition, putting a college education out of reach for many families.[9]

[9] Kansas Center for Economic Growth

Income Level Impact of Proposed Changes to Missouri Tax Structure Missouri Residents, 2013 Income Levels Source: Institute on Taxation and Economic Policy							
2013 Income Group	**Lowest 20%**	**Second 20%**	**Middle 20%**	**Fourth 20%**	**Next 15%**	**Next 4%**	**Top 1%**
Income Range	Less Than $18,000	$18,000–$33,000	$33,000-$52,000	$52,000-$83,000	$83,000-$157,000	$157,000-$391,000	$391,000 Or More
Average Income in Group	$11,000	$25,000	$42,000	$67,000	$109,000	$227,000	$1,094,000
50% Deduction for Business Income							
Tax Change as % of Income	–0.0%	–0.0%	–0.0%	–0.1%	–0.1%	–0.4%	–0.8%
Average Tax Change	-$1	-$10	-$16	-$43	-$127	-$873	-$8,815
Share of Tax Change	0%	1%	2%	5%	12%	22%	57%
Cutting the Top Individual Income Tax Rate from 6% to 5.5%							
Tax Change as % of Income	–0.0%	–0.1%	–0.1%	–0.2%	–0.2%	–0.3%	–0.3%
Average Tax Change	-$0	-$13	-$47	-$102	-$242	-$648	-$3,779
Share of Tax Change	0%	2%	7%	15%	27%	20%	29%

Neither Bill Would Create Jobs

While the proposals are purported to incentivize job creation, it is highly unlikely that either proposal would result in increased jobs. **In fact, the majority of academic studies have found no correlation between state tax levels and state economic performance.**[10]

A 2013 analysis by the Center on Budget & Policy Priorities demonstrated that cutting state individual income tax, through rate reductions or a business income deduction, is unlikely to foster small businesses to create jobs. That analysis found that: [11]

- **The vast majority (87 percent) of small businesses nationwide make less than $50,000 in taxable income.** As a result, even eliminating the state tax for these businesses would provide too little cash flow to cover a full-time worker's salary.

- Just 11 percent of those that report business income nationally own a small business that employs workers beyond the owner(s), **and a 2011 survey of small business owners found that the vast majority report that they don't have a desire to expand.**

[10] See: Center on Budget & Policy Priorities, "*Cutting State Personal Income Taxes Won't Help Small Businesses Create Jobs and May Harm State Economies*," February 2013; Center on Budget & Policy Priorities, "*Academic Research Lacks Consensus on the Impact of State Tax Cuts on Economic Growth*", June 2013; Institute on Taxation and Economic Policy, "*States with "High Rate" Income Taxes are Still Outperforming No-Tax States*", February 2013
[11] Center on Budget & Policy Priorities, "*Cutting State Personal Income Taxes Won't Help Small Businesses Create Jobs and May Harm State Economies,*" February 2013

- **Businesses both small and large expand their workforce when demand for their product or service increases, regardless of state tax rates.**

- **Further, economic studies demonstrate that there is no correlation between state individual income taxes and entrepreneurial activity.**

In addition, recent employment figures from Kansas and Oklahoma, where state lawmakers approved steep tax cuts in recent years, demonstrate that the theory that tax cuts drive job creation isn't true. In fact, comparing the most recent employment data shows that Missouri's job growth outpaced both states over the last year.

Missouri's Job Growth Outpaced Both Kansas and Oklahoma January – November 2013[12] In thousands			
	January-November 2013 Monthly Avg.	**January-November 2013 % Change**	**National Rank (Including D.C.)**
TOTAL EMPLOYMENT			
Kansas	1372.1	1.19%	21st
Missouri	**2698.8**	**1.64%**	**11th**
Oklahoma	1621.9	1.00%	26th
SERVICE PROVIDING: Consists of Retail Trade, Transportation & Utilities			
Kansas	1142.4	1.16%	
Missouri	**2336.6**	**1.33%**	
Oklahoma	1360.7	1.14%	
GOODS PRODUCING: Includes Manufacturing			
Kansas	229.7	1.36%	
Missouri	**362.2**	**3.62%**	
Oklahoma	261.2	0.27%	
TOTAL PRIVATE SECTOR			
Kansas	1114.2	1.05%	
Missouri	**2264.9**	**2.20%**	
Oklahoma	1272.8	1.03%	

[12] Bureau of Labor Statistics; State Employment Data, Seasonally Adjusted: Table D-1. Employees on nonfarm payrolls by state and major industry, seasonally adjusted