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## Tax Proposals Carry \$1.4 Billion Price Tag: Why HB 327, HB 444, and SB 30 are Dangerous for Missouri

By Amy Blouin, Executive Director

Three significant tax proposals--House Bill 327, House Bill 444, and Senate Bill 30-- are moving forward in the Missouri Legislature. If these bills gain final approval in their current form, the combined result will cost the state nearly \$1.4 billion per year when fully phased in.

The loss of this magnitude of revenue would result in a severe budget emergency within two years. Even if the bills are “trimmed” back to their original cost of approximately \$150 million, they will result in significant cuts to nearly all services.<sup>1</sup>

### Major Provisions of Three Tax Cut Bills

#### **Senate Bill 30: Cost Estimate \$1.163 Billion per Year When Fully Implemented<sup>2</sup>**

Senate Bill 30 began as a very small sales tax exemption for “common carriers”. The initial cost of the bill was “unknown” in official state fiscal notes, but presumed to be relatively small. The bill became a legislative “Christmas Tree” with a plethora of amendments to create various tax cuts and incentives. The current version of the bill would eliminate the Corporate Income Tax for new Manufacturers; Provide Sales Tax Exemptions for television broadcasters, coin operated amusements, common carriers, biotech research, and even bowling equipment; Provide Gas Tax Exemptions for public transit systems; Provide Tax Credits for military retirement benefits; Provide Tax Credits for Tuition paid to Public and Private Missouri Colleges, and Provide Full Deductibility of Federal Taxes for the purpose of State Income Tax calculation.

<sup>1</sup> Even a \$100 million dollar tax cut will lead to a \$500 million budget shortfall by fiscal year 2010 see: “\$500 Million Reasons to Be Concerned about a Tax Cut in Missouri” Analysis is available on the MBP website at: <http://www.mobudget.org/Tax%20Cut%20Impact%20Mar%202007.pdf>

<sup>2</sup> The cost estimates of SB 30 are Missouri Budget Project estimates based on state revenue records. The state does not yet have an official fiscal note for the current bill.

**House Bill 444: Tax Cut on Social Security Income: Cost Estimate \$137 Million per Year When Fully Implemented** The Senate Ways and Means Committee passed a substitute version of the bill that would exempt Social Security Income from State Income Tax. The substitute phases in the tax cut over a 6 year period, beginning in tax year 2007. In Tax Year 2007 20% of Social Security Income would be exempt from state income tax, with a state cost of \$24 million. The exemption increases to 100% of Social Security Income by Tax Year 2012 with a fully phased in cost of \$137 million per year.

**House Bill 327: Cost Estimate \$96 Million per year when fully implemented** House Bill 327 began as a relatively small adjustment of Missouri's "Quality Jobs Act" for economic development. The initial cost of the bill was estimated to be \$14 million. It has also grown to include a plethora of tax credits including: film production tax credits, enhanced enterprise zones, Civil War site tax credits, and small business credits.

## Seven Reasons Why Tax Cuts will Hurt the State & Missourians

### 1. Missouri's Revenue Growth Has Slowed

Recent strong revenue growth in Missouri has led to a common misperception that the state has effectively rebounded from the budget crisis of the last six years. In Fiscal Year 2006 net revenue grew at 9.2%, well higher than anticipated, allowing the state to carry forward \$300 million in revenue. However, for the current Fiscal Year 2007 to-date net general revenue has slowed to a rate of 4.8% and the official state estimate for Fiscal Year 2008 which begins on July 1 indicates revenue growth for the next year declining to 3.8%.

The slowing revenue growth and estimates through fiscal year 2010 reveal that the state is likely to face significant budget shortfalls. Even without a tax cut or significant spending changes, the state "surplus" will be used up within the next two years just to meet ongoing budgetary needs. By Fiscal Year 2010 the Missouri Budget Project anticipates at \$200 million shortfall.

Similar revenue trends are occurring nationwide. Responses to a recent survey of legislative budget offices by the National Conference of State Legislatures indicated that nearly half of all of the states projected budget shortfalls within the three-year period of Fiscal Years 2007 through 2009.<sup>3</sup> Many of these same states had reported "surpluses" in the previous year or two.

### 2. Even a \$100 Million Tax Cut will cause a Severe Budget Shortfall

Should even a modest tax cut package be enacted, the state is in jeopardy of falling back into dire financial straits. The Missouri Budget Project estimates that a \$100 million tax cut will result in a \$500 million shortfall by Fiscal Year 2010. State estimates concur. In a "Confidential" document prepared by the Senate Appropriations Staff, the Senate staff estimate that a \$100 million tax cut will result in a budget shortfall of \$83 million as quickly as Fiscal Year 2009, just one year from now.<sup>4</sup> The state is simply not in a position to fund a tax cut without a direct reduction of services.

<sup>3</sup> Elizabeth C McNichol and Iris Lav, "State Budgets on the Edge?", Revised November 8, 2006, available at [www.cbpp.org](http://www.cbpp.org)

<sup>4</sup> This document has not been broadly released, and was not directly provided by the Senate Appropriations Staff to the Missouri Budget Project. However, as an official state document, created by state staff and resources, it is subject to the State's "Sunshine Law". The documents are labeled "Confidential" and project only through Fiscal Year 2009.

### **3. Experience of Other States Calls for Caution on Phased-in Tax Cuts**

The current version of the tax cut bills in Missouri are written to be phased-in over the next six years. As a result, the true cost of the bills is hidden in future years. Without a growing revenue source to fund the growing cost of the tax cuts, the state will be forced to reduce services.

Nine states are facing similar dilemmas due to phased-in tax cut packages passed in 2006. The cost of the tax cuts in these states is expected to more than quadruple from their initial first year impact to their fully implemented levels a few years from now. As an example, Oklahoma passed a tax reduction package in 2006 that is estimated to grow from a cost of \$95 million in the first year to \$628 million, or six times the initial amount, by 2011.<sup>5</sup> As a result, these states will not face the full cost of the tax cuts until long after their current budget year, leaving future budget makers to deal with the consequences.

Due to the declining revenue growth projections, it is clear that what Missouri can not afford in the current year's budget will not be affordable in future years. If phased-in tax cuts are passed, future legislatures will be forced to make severe cuts resulting from the short-sighted tax cuts passed by their predecessors.

### **4. Services for All Missourians are at Risk; Education, and Health Care are still below 2001 levels**

Missouri has not yet fully recovered from the fiscal crisis of the last five years. State aid to local school districts remains \$600 million under its required funding levels; Missouri public universities receive less money in the current year than they did in 2001, resulting in tuition increases of 60% over five years. More than 200,000 Missourians have lost access to public health care due to the Medicaid cuts. The state is not providing the same level of services it provided just five years ago.

If a tax cut is passed, public services that benefit all Missourians will be reduced even further. As discussed earlier, even a \$100 million dollar tax cut will result in a \$500 million shortfall by Fiscal Year 2010. That amount would require budget cuts equaling more than 6% of the state's approximately \$8 billion general revenue fund budget. A larger tax cut would create an even greater burden to state services that would be reduced to fund the tax cuts.

### **5. Low and Moderate Income Families will not benefit from Tax Cuts Proposals**

Working families in Missouri are not benefiting from the current economic recovery.<sup>6</sup> The median income in the state remains more than \$5,000 lower, a full 10%, than what it was in 2001.<sup>7</sup> According to the U.S. Census Bureau, poverty has increased to 11.9% of the population, nearly two percentage points above the 2001 recession level rate of 9.4% in Missouri.<sup>8</sup>

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<sup>5</sup> Nicholas Johnson and Sarah Farkas, "Tax Cuts on Layaway: The Short and Long Term Fiscal Implications of 2006 State Tax Actions", October 10, 2006, available at [www.cbpp.org](http://www.cbpp.org)

<sup>6</sup> Economic Policy Institute and Center on Budget & Policy Priorities, "Pulling Apart: A State by State Analysis of Income Trends", January 2006 available at [www.epi.org](http://www.epi.org) and [www.cbpp.org](http://www.cbpp.org)

<sup>7</sup> Amy Blouin and Ruth Ehresman, "New Census Data Indicate Missouri Families are Losing Ground: A Story of Unequal Prosperity", August 29, 2006" available at [www.mobudget.org](http://www.mobudget.org)

<sup>8</sup> IBID

Working families in Missouri are also more likely to be more harshly impacted by the various service reductions resulting from the state budget cuts. Tuition increases at Missouri universities are a greater burden for low-income families; and Medicaid and other health care cuts have directly impacted low-income working families and their children.

The proposed state tax cuts would create an even larger burden on the state's budget and services, with little benefit for Missouri working families. All three tax cut proposals are largely written to benefit corporations or provide tax reductions to higher income Missourians, but would do little to reduce taxes for low-income working families in Missouri.

In addition to the corporate tax credits and tax incentives that are mentioned in the bill summaries, two specific tax cut provisions are skewed to benefit only wealthy Missourians.

One of the costliest provisions in Senate Bill 30 is to allow Missouri taxpayers to deduct the full amount of federal taxes from their state income tax. This provision alone would cost the state more than \$450 million annually.<sup>9</sup> Yet, according to the *Institute for Tax and Economic Policy*, this deduction would benefit mostly high-income families. Low-income families who pay very little in federal taxes would receive little to no state tax reduction. Only three states allow taxpayers to fully deduct federal income taxes from state tax liability, and just seven states allow taxpayers to deduct a portion of their federal income tax, including Missouri.<sup>10</sup>

In House Bill 444, income from Social Security would be exempt from state income taxes. However, less than half (40.5%) of Missouri's 493,000 senior households who receive Social Security benefits would be eligible for a tax reduction through this proposal. Low-income seniors, earning less than \$50,000 per year and those who rely primarily on Social Security income will generally receive no benefit because they are already exempt from tax on this income. The lowest income senior households, those with incomes less than \$20,000 per year, would receive no tax reduction.<sup>11</sup>

## **6. Tax Cuts Funded by Service Reductions Could Harm Missouri's Economy**

A growing body of economic literature documents that tax cuts, when funded by budget cuts and reductions in public services actually impede the economy:

*"...revenues provided by taxes strengthen, not weaken, our nation's economy. They fund essential public goods and services, they contribute positively to national saving and many of the things that they fund – from highways and schools to biomedical research and national parks – indirectly create private wealth as well. As Justice Oliver Wendell Holmes put it in 1927, "Taxes are what we pay for a civilized society"."*

*- Diane Lim Rogers, Research Director, Brookings Institution, printed in the Boston Globe on April 16, 2006.*

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<sup>9</sup> Missouri Budget Project estimate of the tax cut, based on State Revenue documents. There is no official "fiscal note" on the current bill.

<sup>10</sup> Institute for Tax and Economic Policy, Email Communication from Kelly Davis, April 19, 2006.

<sup>11</sup> Amy Blouin, "Elimination of State Social Security Tax: A Big Price Tag with Little Benefit for Missouri Seniors", March 6, 2007, available at [www.mobudget.org](http://www.mobudget.org)

*The current chairman of President Bush’s Council of Economic Advisors, Edward Lazear” said, “I certainly would not claim that tax cuts pay for themselves”, when testifying before Congress’s Joint Economic Committee last summer.<sup>12</sup>*

A 2004 study of the link between economic development and state and local taxes by economist Robert Lynch further found that the business climate is not impeded by higher taxes. In fact, the study reviewed economic literature throughout the nation and determined that state and local tax rates have little impact on businesses when the selecting states in which to locate.<sup>13</sup>

Particular types of state spending are especially beneficial to economic growth because they maximize federal funding that enters the state. Economists from Saint Louis University who conducted a Missouri-specific study on the economic benefits of Medicaid spending found that for every \$1 million the state spends in Medicaid health services, an additional \$3 million in business activity and 42 jobs are produced.<sup>14</sup>

Missouri’s fiscal outlook indicates that the state does not have a long-term funding source for the tax cuts. If passed, the tax cuts would necessitate budget cuts and service reductions. The state’s ability to fund services that drive the economy including schools, transportation, health and other infrastructure needs will be severely compromised.

## **7. Tax Cuts will not Solve Missouri’s Problems**

Even without a tax cut, Missouri faces a shortfall beginning in Fiscal year 2010. Missouri has not yet recovered from the budget cuts of the last five years, and services are at risk of additional cuts in the relatively near future.

Compared to other states, Missouri’s tax base and services are extremely low. Missouri now ranks 46<sup>th</sup> nationally in state government revenue as a percent of personal income, and ranks 44<sup>th</sup> for per capita total state government expenditures.<sup>15</sup>

Given the grim nature of the state’s revenue situation, and continuing erosion of services, Missouri policy makers should conduct a thorough conversation about the state’s spending priorities before any significant changes occur in either spending or tax policies.

*The Missouri Budget Project is a statewide, nonprofit fiscal analysis organization that informs the public about the state’s budget and tax policy options...and their impact on low and moderate income Missourians.*

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<sup>12</sup> “Oklahoma Budget Outlook”, March 2007, Oklahoma Community Action Project, available at [www.okpolicy.org](http://www.okpolicy.org)

<sup>13</sup> Robert Lynch, “Rethinking Growth Strategies: How State and Local Taxes Affect Economic Development”, Economic Policy Institute, March 2004.

<sup>14</sup> Missouri Foundation for Health “Show Me Series Report 5: Economic and Health Benefits of Missouri Medicaid”, Spring 2004, available at [www.mffh.org](http://www.mffh.org)

<sup>15</sup> Morgan Quitno State Ranks 2007