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Proposal to Drastically Change Missouri's Tax Structure Would Burden Missouri Families and Economy: Consequences of HJR 56, HJR 71 and SJR 29

Missouri lawmakers are currently considering proposals which would make dramatic changes in the state's revenue structure by eliminating individual and corporate income taxes and replacing them with a greatly expanded sales tax. This shift would create a significant tax increase for low and middle income Missourians, and would place a heavy burden on Missouri's economy. Three bills that make this change have been introduced in the Missouri Legislature this session, including HJR 56, HJR 71 and SJR 29.

There are several critical facts and uncertainties to be aware of in these proposals:

- ✓ They would eliminate Missouri's individual and corporate income taxes, current statewide sales taxes, and St. Louis and Kansas City earnings taxes. The total revenue generated by these sources averaged $9 billion in fiscal years 2006 - 2008.

- ✓ In addition, the proposals would create a new tax "tax - prebate" for Missourians based on the poverty level for the family size multiplied by the sales tax rate.

- ✓ To make up for the costs of the proposals, including the elimination of current taxes and the cost of the rebate , **the proposal would increase both the statewide sales tax <u>rate</u> (how much we pay) and the sales tax <u>base</u> (what we pay taxes on)**. The expanded sales tax would apply to virtually everything Missouri consumers buy, with the sole exception of higher education tuition and fees, and would exempt all business-to-business transactions.

- ✓ The Missouri Budget Project's most recent analyses of personal consumption data from the Bureau of Economic Analysis indicates that the new Missouri Sales Tax Rate **would likely need to increase to at least 11 percent, more than double the rate suggested by its sponsors, to make the plan revenue-neutral overall.**[i] If additional goods and services are exempted, the sales tax rate would need to increase even higher to cover the costs of the bill.

- ✓ **Most goods and services, including those not currently taxed,** would become eligible for the newly increased sales tax, including:
  - Nursing home and in-home medical care
  - Doctor's visits
  - Child Care and educational services
  - Rent, housing, and home repairs
  - Purchase of new homes
  - Utilities and telephone services
  - Health and auto insurance
  - Funerals
  - Food & prescription drugs
  - Legal counseling & financial services
  - Transportation
  - Private K-12 school tuition
  - Mental health, and disability services
  - Club dues and religious activities
  - Auto repairs
  - **And many more currently untaxed products and services**

- ✓ Taxing these services would place a particular burden on young families and Missouri's seniors.
  - The average family of four, with two working parents and two children (one school age and one infant) would pay at least $798 per year in additional tax just for child care.
  - Missouri seniors who require nursing home services would pay, at minimum, $2,640 in tax for assisted living and $7,040 in tax for nursing home care.

- ✓ Families with fixed incomes, like Missouri Seniors, would have their monthly costs increase by 11 percent while tax discounts would be decreased or eliminated. For example, the proposal would eliminate all tax credits, including the Senior Citizen Circuit Breaker, which seniors and people with disabilities currently receive to offset some of their local property tax. Because seniors would lose current tax deductions and exemption, and they tend to spend a larger portion of their income on expenses that would become taxed under this proposal**, seniors will end up paying a much greater share of their income in tax.**

- ✓ Because the increased sales tax rate would apply to all purchases, including items that are currently not taxed such as food and prescription drugs, the cost of living in Missouri will increase dramatically.

- ✓ The proposed rebates for taxpayers, intended to alleviate some of the increased costs, will do little to defer a family's cost, but require the state to collect more to meet its needs. The proposals are unclear as to who would qualify for the rebate, what amount the rebate would be and if the calculation would change over time as inflation and costs increase.

- ✓ **Most Missourians would pay considerably more in tax under this plan than they currently do.** In fact, the only Missourians who wouldn't pay higher taxes under the plan are the wealthiest 5 percent of Missourians. **Middle-Income Missourians would bear the brunt of the increase because they are most likely to spend a greater portion of their income on taxable products and services**. Because state income tax deductions would be eliminated, a larger portion of income would be taxed as well.

- ✓ **Proponents have claimed that the state's new sales tax rate would be 5.11 percent to cover the costs of the bill. However, there is broad agreement among policy experts on both sides of the issue that this amount is far too low**. The Missouri Budget Project, the Institute on Taxation and Economic Policy, the Show Me-Institute, Jim Moody (former Commissioner of the Office of Administration and former State Budget Director) and others agree that a 5.11 percent rate is too low. As a result, if the proposal went to the ballot as currently written, Missouri voters would be voting on an incorrect rate and therefore would have been considerably misled regarding the impact.

- ✓ The proposals rely on the legislature to pass an increased tax rate after the first year of implementation if 5.11 percent proves insufficient. However, if the legislature failed to pass a tax rate increase, the state would face a minimum of a $5 billion shortfall, resulting in severe cuts to state programs and services, including education, transportation and job training.

- ✓ The increased tax would make Missouri retailers, service providers, and the state's economy much less competitive than surrounding states. **In border areas of the state, Missourians may cross state lines to make purchases in a state with a lower tax rate**. In addition, many Missourians may cross state lines to secure services simply because most states do not currently tax all services, as Missouri would under the proposal.

- ✓ Missouri's new statewide sales tax rate (not counting any local-option taxes that currently exist) would become approximately 11 percent, compared to the following neighbors:

    - Illinois: 6.25 percent
    - Kansas: 5.3 percent
    - Arkansas: 6 percent
    - Iowa: 5 percent
    - Tennessee: 7 percent
    - Oklahoma: 4.5 percent

- ✓ The proximity of major metropolitan areas of Missouri to other states that would have lower sales tax rates means that **the burden of these proposals would fall mainly on rural Missouri.**

- ✓ **Unlike the other states currently operating without an income tax, Missouri does not collect significant revenue from tourism or oil and coal severance fees.**

- ✓ The proponents of the measure have compared this change to Tennessee's tax structure. However, Tennessee does not have the same tax or tax rate that Missouri would under this plan. In fact **no other state taxes services as broadly as Missouri would under this plan.** **There simply is no comparison for Missouri to use to assess this proposal. It is untested.**

- ✓ Tax administration would become much more complex in Missouri as service providers and others would become new tax collectors.

During these difficult economic times, it is especially risky for Missouri to make such a drastic move to rely solely on sales tax revenue to meet our state budgetary needs. These proposals would shift the responsibility for funding state services and infrastructure, which benefit all Missourians and our state economy, from a system that that relies on the shared responsibility of individuals and business to a system that relies entirely on individuals**. The change would be constitutional, so even if Missouri legislators later wanted to make changes it would be incredibly difficult to amend.**

The Mission of the Missouri Budget Project is: To advance public policies that improve economic opportunities for all Missourians – particularly low and middle-income families – by providing reliable and objective research, public education and advocacy. More information is available at www.mobudget.org.

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[i] Personal Consumption Expenditure (PCE), as reported by the Bureau of Economic Analysis, includes spending by individuals from all sources, including businesses and governments, and also includes spending on behalf of individuals. Some elements of PCE (such as health care spending by governments) would amount to government taxing its own activities, while others (such as taxing purchases made with food stamps) would actually violate federal law. For these reasons, PCE must be adjusted downwards in a variety of ways to reflect the share of consumption actually made directly by individuals that can legally (and practically) be taxed. Working with the Institute on Taxation and Economic Policy, MBP conducted an intensive review of the PCE data to determine what items could accurately reflect the base of what would be taxed. The result is that the sales tax rate would need to be 11 percent at minimum to cover the minimum costs of the proposal. See "Determining the Statewide Sales Tax Rate", February 9, 2010; available at www.mobudget.org and www.itepnet.org